THE FEDERAL BUDGET FOR 1987

HEARING

BEFORE THE

COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES
NINETY-NINTH CONGRESS
SECOND SESSION

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THE FEDERAL BUDGET FOR 1987

THURSDAY, FEBRUARY 6, 1986.

OVERVIEW HEARING OF FISCAL YEAR 1987 BUDGET

CONGRESSMAN JAMIE L. WHITTEN, CHAIRMAN

OPENING STATEMENT

HON. JAMES BAKER, SECRETARY OF THE TREASURY
HON. JAMES MILLER, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
HON. BERYL SPRINKEL, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

INTRODUCTION OF WITNESSES

Chairman WHITTEN. I would like to welcome our guests before the full Appropriations Committee this afternoon.

Honorable James Baker, Secretary of Treasury;
Honorable James Miller, Director of OMB; and
Honorable Beryl Sprinkel, Chairman—Council of Economic Advisers.

We greatly appreciate you being with us today. We recognize the demands upon your time, especially during this period shortly after the submission of the Budget.

As has been the custom in recent years, we are under the watchful eye of our good friend Jack Brooks, who has lent us this hearing room. On behalf of the entire committee I would like to thank Chairman Brooks and the Government Operations Committee for their continued fine cooperation.

Though our Committee on Appropriations has held the line and recommended appropriations $11,200,000,000 below the President's request for fiscal year 1985 and $12,900,000,000 below the President's request for fiscal year 1986 the debt has increased tremendously—largely because of the 1981 tax bill which repealed the windfall profits tax and permitted the sale of tax credits, and the increase in appropriations for military spending from $180,001,000,000 in 1981 to $320,000,000,000 requested in the current year's budget.

During this same period, of the 74 appropriations bills we have passed, the President has signed 69 and has vetoed five bills. We overrode one of the bills and worked out the other four.

When the current administration took office in January 1981, the national debt stood at $932 billion. At the end of FY 1985 it was $1.8 trillion. By the end of FY 1986 it will exceed $2.1 trillion and is projected to increase to $2.3 trillion by the end of FY 1987. In the short period of five years, the national debt has more than doubled. The increase alone in the debt in the past five years exceeds all the debt accumulated since the beginning of the republic, through the Civil War, two World Wars, the Great Depression, the Korean conflict, and the Vietnam War. And this doubling of the debt took place during peacetime.

We are a debtor nation for the first time since 1914 with foreign investment in the U.S. totalling some $925.9 billion in 1985. Table A shows this clearly.

The following table shows the growth of foreign investment in the U.S. Besides the actual amount of growth each year, it is important to note that these figures show that for the first time since 1914 the U.S. became a net debtor nation. In other words there was more foreign investment in the U.S. than there was U.S. investment in foreign countries.

TABLE A.—FOREIGN INVESTMENT IN UNITED STATES

[Billions of dollars; end of period]

	1978	1979	1980	1981	1982	1983	1984	1985
U.S. Assets Abroad	447.8	510.6	606.9	719.7	839.0	893.6	914.7	919.5
Official Reserve Assets	18.7	19.0	26.8	30.1	34.0	33.7	34.9	35.5
Other Government Assets	54.2	58.4	63.5	68.4	74.3	79.2	84.6	86.4
Private Assets	375.0	433.2	516.6	621.2	730.7	780.8	785.1	797.5
Foreign Assets in U.S.	371.7	416.1	500.8	579.0	692.0	787.6	886.4	925.9
Foreign Official Assets	173.1	159.9	176.1	180.4	189.2	194.5	199.0	196.0
Other Foreign Assets	198.7	256.3	324.8	398.6	502.8	593.1	687.4	730.0
Net Investment Position	76.1	94.5	106.0	140.7	147.0	106.2	28.2	−6.5

Our trade balance is unbelievably bad, with the 1985 figures showing a gap of $148.5 billion. In 1981 this gap was $27.9 billion. For 1985 this means we bought on credit $148 billion more in commodities and merchandise abroad than we exported. Most of this we could have produced ourselves.

We are $49.7 billion out of balance with Japan alone; yet we still spend approximately $1.6 billion to keep troops in Japan—money which the Japanese in effect use to buy into our country. In Germany, we spend some $4.5 billion for troops with a similar effect.

American agriculture is bankrupt because we have had the farmer financing our foreign policy—with agriculture embargoes in 1973, 1974, 1975, and 1980 under the former President, and continued for the past five years.

Since we do not make our offering price competitive as authorized by law, our income from agriculture exports, our biggest industry, has dropped from $43.8 billion in 1981 to $31.2 billion in 1985 with a further drop projected to $29.0 billion in 1986.

Today, not only has our debt more than doubled to over $2 trillion, but large sections of our nation's industry are bankrupt. The textile industry is facing bankruptcy from imports—with similar disasters in shoes and steel and others. Land values have dropped as much as 75%. Foreign countries are buying into our industries. Our notes which they hold are buying our land, building our shopping centers.

In 1985 more banks failed than in any year since the Depression. A total of 120 banks—including 62 agricultural banks—failed. Others are on the brink. This represented an increase of more than 50 percent over the previous post-Depression high of 79 in 1984. By the end of 1985 some 437 agricultural banks had been placed on the "problem list" of the FDIC. Thousands of farmers have lost their land.

As you see from these facts, our problems are economic and cannot be ignored. Of course we need a strong defense but our economy certainly should not be destroyed to increase the carryover of unspent military funds now more than $299 billion in FY 1987. But that is meaningless unless we have a strong economy worth defending.

Last year when the Committee on Appropriations submitted its official report to the Budget Committee, we pointed out a number of factors. Let me read from that report.

> The Committee on Appropriations recognized that the soundness of our defense, including Department of Defense procurement, our military forces, and related programs depend upon a healthy domestic economy and public support. To retain these essentials, it is absolutely necessary to protect and develop our physical resources and protect essential domestic programs that we may retain public support. It is our country and our people on which all else depends.
>
> If the proposed domestic reductions were to be adopted by the Congress, it would weaken the nation's ability to maintain a strong economy which is essential for public support and a strong defense.
>
> In past years, the Congress has not cut military spending; it has only reduced the rapid rate of increase proposed by the Administration.

Now that's what we said last year. And it was true.

But this year, even though our problems are worse, you seem to have proposed more of the same.

You propose to increase military spending so that the carryover balances are even larger; cut domestic spending to levels that are not acceptable to the Congress and the American people; and ignore the revenue effects of your previous policies.

For FY 1987 the Administration is proposing to increase military spending by $34.2 billion in new budget authority and from $16 to $26 billion in outlays. This is at the same time when carry over balances will increase by $37.3 billion providing an unexpended balance of $299.7 billion in FY 1987. Table B clearly shows this.

TABLE B.—INCREASED CARRYOVER BALANCES: DEPARTMENT OF DEFENSE

[In billions of dollars]

	Unobligated balances	Unexpended balances
Fiscal year:		
1975	$16.7	$44.0
1976 (transition quarter)	21.0	51.4
1977	20.0	62.6
1978	21.3	73.6
1979	23.0	83.9
1980	24.2	92.2
1981	26.5	112.8
1982	34.6	142.2
1983	43.4	172.1
1984	51.6	205.1
1985	61.5	244.3

TABLE B.—INCREASED CARRYOVER BALANCES: DEPARTMENT OF DEFENSE—Continued

[In billions of dollars]

	Unobligated balances	Unexpended balances
1986 estimate	59.9	262.4
1987 estimate	60.3	299.7

We need a strong defense—but we can never have a strong defense unless it is backed by a strong country—strength that can only come by developing our nation's resources—our real wealth—with an educated, healthy populace, with adequate food and nutrition flowing from a strong agriculture base.

While proposing to add huge sums to military spending, you propose to cut or eliminate those very programs that are essential to a strong defense.

Let me just read a few of these programs, and you will quickly see how our economic vitality is being reduced. These are programs which the budget would eliminate but which would not apply to the debt but to add to the carryover of unspent military funds.

Agriculture conservation programs	$497,900,000
Rural Development programs	2,801,500,000
Farm loan programs	1,220,000,000
Agricultural research and extension	118,805,000
EDA	201,000,000
NOAA sea grants and coastal zone management grants	75,000,000
Juvenile justice and delinquency prevention	64,693,000
Legal Services Corporation	305,500,000
Small Business Administration	223,000,000
Appalachian Regional Commission	117,000,000
Export-Import Bank	1,062,300,000
Sub-Saharan African Facility	71,800,000
Urban Development Action Grants	330,000,000
General Revenue Sharing	4,185,000,000
Land and Water Conservation Fund	49,700,000
Indian Health Service programs	78,585,000
DOE—Low Income Weatherization Assistance	182,084,000
Strategic Petroleum Reserve	446,484,000
Health professions assistance	224,000,000
Work Incentives program	220,000,000
Community Services Block Grant	367,000,000
Impact aid "b" payments	130,000,000
Library assistance	128,000,000
Amtrak	590,000,000
Mass Transit grants	1,000,000,000
Washington Metro construction	217,000,000
Postal Service—revenue foregone	708,000,000

Significant reductions

Food Stamps	$313,300,000
Child Nutrition	755,500,000
DOE—Research	721,025,000
HUD—Assisted Housing Programs	10,566,000,000
HUD—Community Development Grants	1,000,000,000
VA—Medical Care	400,000,000
VA—Construction	200,000,000
EPA—Construction Grants	600,000,000
Interior—Land Acquisition and construction programs	219,992,000
Jobs Corps	288,000,000
Summer Youth	236,000,000
National Institutes of Health	417,000,000

Rehabilitation and handicapped services	244,000,000
Vocational Education	440,000,000
Student financial assistance	1,073,000,000
Public Broadcasting Support	84,000,000
UMTA—formula grants	1,000,000,000
Interstate transfer grants	400,000,000
Coast Guard—Construction	130,856,000

The deficit problem is not caused by the controllable domestic programs. It is primarily caused by legislation resulting in revenue loss on one side and huge increases in military spending on the other side. Those are the plain and simple facts.

These proposals in this budget won't solve the problem and if adopted would make bad matters worse.

I also serve as Chairman of the Subcommittee on Agriculture, Rural Development, and Related Agencies and will include at this point in the record a summary of the programs that are proposed for termination or reduction in the budget for the Department of Agriculture.

AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES, FY 1987

SUMMARY OF REQUEST

[New budget authority]

	Enacted FY 1986	President's FY 1987
USDA	[1] $36,848,645,000	$41,566,692,000
FDA	424,293,000	423,600,000
CFTC	29,240,000	30,418,000

[1] Supplemental of $7.9 billion for CCC pending.

Major Issues

1. The budget again proposes a permanent indefinite appropriation for CCC—"such sums as necessary" not only for 1986 but for each year thereafter. Under this proposal, CCC would no longer be funded by appropriation. (FY'87 budget authority estimate is $16.8 billion and the FY'86 supplemental estimate is $8.8 billion.)
2. The budget would terminate all housing loans, all rural development loans and grants, begin the phaseout of REA and terminate all of the conservation and flood control programs.
3. The budget would reduce Extension formula funds by 45 percent and all of the earmarked programs would be terminated.
4. The budget proposes a $35.0 million net *increase* for the Agricultural Research Service and a $32.6 million net *decrease* for the Cooperative State Research Service.
5. Legislation will be proposed to fund a number of *agencies* or programs through "user fees". Appropriations are requested for these agencies and programs but the estimated user fees are netted out of the budget. If legislation is not enacted to authorize these user fees, the budget will be understated by over $500 million.
6. The budget proposes in FY 1986 to rescind $700 million in housing loans and $227 million in conservation and flood control funds.

Program cuts

1. Program eliminated	$4,600,000,000
2. Programs reduced	2,318,000,000
3. User fees	534,200,000
4. Rescissions	1,056,205,000

I. Programs Eliminated

Conservation programs:	
Agricultural conservation program	$190,000,000
Watershed and flood prevention operations	223,843,000

Great Plains conservation program	21,531,000
Water bank program	8,800,000
Forestry incentives program	12,500,000
Resource conservation and development	26,320,000
River basin surveys and investigations	14,906,000
	497,900,000
Rural development programs:	
All rural housing loans	2,112,000,000
All rural development loans	540,000,000
All rural grants	169,500,000
	2,821,500,000
Farmer programs:	
Farm ownership loans	520,000,000
Emergency loans	700,000,000
	1,220,000,000
Research and Extension:	
Special research grants	29,000,000
Animal health grants	5,600,000
Expanded food and nutrition education program (EFNEP)	60,354,000
Urban gardening	3,500,000
Farm safety	1,020,000
Financial management assistance to farmers	1,500,000
Renewable resource extension	2,500,000
Pest management programs	7,531,000
Graduate fellowships and Morrill-Nelson	4,800,000
Foreign currency research	3,000,000
	118,805,000
Animal and plant health:	
Animal welfare and horse protection	5,024,000
Imported fire ant	5,809,000
Noxious weeds	789,000
Pseudorabies	2,322,000
Witchweed	4,723,000
	18,667,000
Agricultural marketing:	
Wholesale market development	1,582,000
Federal-State market improvement program	990,000
Feeding programs:	
Temporary emergency food assistance program	50,000,000

II. Significant Program Reductions

REA loans and guarantees	$1,100,000,000
Animal damage control	10,000,000
Extension services/Smith-Lever funds	112,400,000
Foreign market development	12,000,000
Food stamps [1]	313,300,000
Child nutrition programs [1]	755,500,000
Nutrition education and training	(5,000,000)
Special milk [1]	14,900,000
	2,318,100,000

[1] Requires legislation.

III. User Fees

Legislation will be proposed to fund the following *agencies* or programs. If this legislation is rejected—as in the past—the following amounts will need to be *restored* in the appropriation bill:

Food and Drug Administration	$26,000,000
Food Safety and Inspection Service	366,700,000
Federal Grain Inspection Service	6,700,000
Packers and Stockyards Administration	9,200,000
Agricultural Cooperative Service	4,700,000

Agricultural Marketing Service	28,900,000
Animal and Plant Health Inspection Service (various programs)	21,000,000
Rural Electrification Administration (administrative costs) [1]	25,000,000
Agricultural Stabilization and Conservation Service (administrative costs) [2]	46,000,000
	534,200,000

[1] The budget proposes a 5% user fee on all REA loans.

[2] The budget proposes user fees to cover the administrative cost of making price support loans.

IV. Rescissions

Agricultural conservation program	$140,839,000
Watershed and flood prevention operations	60,401,000
Great plains conservation program	6,606,000
Water bank program	8,371,000
Rural clean water program	6,000,000
Dairy indemnity	95,000
REA reimbursement	100,000,000
REA Telephone Bank	28,710,000
Food donations program	5,183,000
Low-income housing (Sec. 502)	460,000,000
Rental housing (Sec. 515)	233,000,000
Other loans	7,000,000
	1,056,205,000

V. Supplementals

1. A request for permanent indefinite authority for CCC. The budget estimates that $8.8 billion is required for the balance of FY 1986.
2. A transfer of $71,598,000 from CCC is requested for ASCS to pay the administrative costs associated with the new Farm Bill.
3. Under the provisions of the new Farm Bill, a supplemental of $35,000,000 for crop insurance was transferred from CCC funds. The budget estimates that a total of $250,000,000 will be required in fiscal year 1986. This transfer bypasses the appropriation process.

Mr. Secretary, Mr. Director, and Mr. Chairman, I would like to hear from each of you to explain how we can live with your budget without the nation's financial condition becoming dangerous.

Secretary **Baker**. Thank you, Mr. Chairman.

I have a written statement which I would like to submit for the record, if there is no objection.

Chairman **Whitten**. Be glad to have that.

PREPARED STATEMENT OF HON. JAMES A. BAKER III, SECRETARY OF THE TREASURY

Mr. Chairman and Members of the Committee, I am pleased to be here today to discuss the state of the economy and the new budgetary path. The major economic objectives of the Administration have been described by President Reagan in his State of the Union Message. Further details on this year's economic and budgetary outlook will be provided this afternoon by CEA Chairman Sprinkel and Budget Director Miller. My remarks are an overview of the current situation.

We seek to build on the foundation of the solid economic performance that has already taken place. The current economic expansion has now moved into its fourth year and shows few signs of slackening. Growth was relatively slow at some times during 1985, but by year-end the economy was gaining momentum.

Some favorable features of last year's economic performance deserve at least passing mention.

Consumer price inflation at 3.8 percent remained in the 3.8 to 4 percent range for the fourth year in a row. A table attached to my prepared statement shows the steady progress that has been made since 1980 when all of the measures of price performance were rising in the double-digit range.

Employment has risen strongly in the current expansion, by more than 9 million people. The unemployment rate has been reduced to below 7 percent and further progress is expected. The U.S. economy continues to display great job-creating ability.

Last year's financial market performance was also encouraging. Record amounts of credit flowed to private borrowers, despite the persistence of large Federal budget deficits. Short-term interest rates are down on average by about ½ percentage point in the past year while many of the long-term rates are down by about two percentage points. The prime rate is down to 9½ percent, the lowest rate in 7 years. Ideally, we would like to have seen interest rates come down even further than they have.

All of this added up to a year of solid economic performance in 1985. The latest economic information is generally favorable. Employment, retail sales, industrial production, personal income, residential construction, new orders and the leading indicators were all rising strongly at year end. The stage has been set for sustained expansion in output, jobs and income.

Sustained economic expansion is one of the most important prerequisites for improving the budget picture, as well as the financial security of the American people. During the current expansion, strong economic growth has been achieved in a much less inflationary environment than in the late 1970's. We must strive to extend that good record into the future.

The Administration forecast, upon which Chairman Sprinkel will comment, calls for 4 percent real growth during the four quarters of 1986. This would seem to be a reasonable expectation. The consensus private forecast has been a little lower, around 3 percent. But the latest economic numbers may well be causing some upward adjustment in the private forecasts. Those of us who advise the President on these matters feel that the current Administration projections are inherently reasonable although we also recongize that economic forecasting is at best an uncertain art.

The inflation outlook is also relatively promising, although the fall in the external value of the dollar will eventually begin to exert a little upward pressure.

The Federal Reserve obviously needs to remain alert to the needs of both the domestic and international financial situations. While they never lack for critics and there is always room for disagreement on the wisdom of some of their specific actions, it seems to me that the Federal Reserve has been doing a good job recently.

I would like to turn briefly now to the influence of the international economy on our own economic and fiscal situation. As a result of intensified efforts at promoting a favorable convergence of economic performance among the major industrial countries we have seen some improvement in the world economy. We expect to build on the progress this year. On balance, we expect stronger European and LDC domestic demand growth this year as they continue the process of shifting from export-led to domestic-led growth. Unfortunately there may be some weakening in Japanese growth as the previous stimulus from the trade sector is sharply reduced.

Exchange markets have recognized these generally favorable developments. The decline of the dollar since its peak last winter has been substantial. The yen is at a seven-year high against the dollar. Well over half of the dollar's rise on a real trade-weighted basis against other industrial countries from the end of 1980 to last winter's peaks has been reversed. This is good news for U.S. industry and agriculture. The U.S. trade deficit is likely to level off later this year. These developments should contribute to a more sustainable medium-term pattern of trade and current account balances. The G-5 meeting last September contributed to these developments. Our recent meeting in London showed that all countries were working to continue efforts for sustainable growth.

Another favorable development has been the downward movement in world petroleum prices. Although not without its costs, on balance this should strengthen growth and lower inflation in most of the world. A few countries and firms will experience problems, but with the U.S. debt initiative and a strongly growing world economy these problems can be handled.

While the international debt situation has continued to improve, economic growth in many debtor countries has remained unsatisfactory, and requires greater emphasis on structural policy reforms within those nations, buttressed by additional international financial support. As you know, the United States proposed last October at Seoul, Korea a "Program for Sustained Growth", involving mutually reinforcing actions by the debtor countries, the international financial institutions, and the commercial banks. The response has been very encouraging, with broad statements of support from the major bank groups in the U.S. and other key creditor nations, from the multilateral institutions and in principle from many of the debtor nations.

There are two major items on this year's fiscal agenda: deficit reduction and tax reform.

The President's budget for fiscal 1987 provides a detailed plan, satisfying the requirements of the Gramm-Rudman-Hollings legislation, by which a balanced budget can be achieved by fiscal 1991. The large budget deficits that we currently face are due to excessive Federal spending. Certainly it is not because the American people are undertaxed. As shown in the chart attached to my prepared testimony, receipts are running a bit above the long run historical average as a share of GNP. Despite frequent claims to the contrary, the 1981 Reagan tax cuts are not responsible for our current fiscal difficulties.

Our problems are on the outlay side of the budget, and that is where the corrective action needs to be taken. Congress shares this view. It has debated this issue and has passed the Gramm-Rudman-Hollings bill to cut the deficit by cutting growth in spending. Outlays will continue to grow in absolute terms along the path projected in the new budget, but the rate of advance will be reduced significantly. Between FY 1985 and FY 1991, nominal Federal outlays would rise on average about 3 percent per year. In the prior six-year period, 1979-1985, the rate of growth was about 11 percent per year. Along the path projected in the new budget, Federal outlays would decline steadily as a ratio to GNP from 24 percent in 1985 to about 19 percent in 1991.

Receipts will be growing strongly in absolute terms as the economy itself grows, but receipts would remain close to a 19 percent ratio to GNP—slightly above historical experience. Receipts are projected to rise by about an average 7½ percent annually between FY 1985 and FY 1991, close to the 8 percent rise averaged in the previous 6 year period. With receipts growing normally and outlay growth restrained to a lower path, the budget will move into balance by 1991.

The reduction in the growth of expenditure required to balance the budget by fiscal year 1991 will not be easy, but the effort deserves strong bipartisan support. It can be done the hard, crude, way, via sequestration across the board. Or it can be can be done more rationally and selectively, with respect for appropriate priorities. The President's budget is carefully drawn to meet the Gramm-Rudman-Hollings targets while preserving essential programs of the highest national priority.

The only alternatives to the domestic spending cuts emphasized in the President's budget are to raise taxes, to lower defense spending, or to cut social security benefits, none of which are acceptable. There should be no illusion that tax increases will somehow provide an easy way out. The President has expressed his views on this issue very clearly. He is firmly opposed to damaging the economy by increasing taxes. Defense, which is the most essential duty of the Federal Government, must be maintained. So must the social safety net, including social security and entitlement programs for the needy.

The outlay reductions would be expected to bring down interest rates with a beneficial impact on the entire economy. In addition, lower interest rates and a declining budget deficit will moderate the rapid rise in interest expense that has developed. This will free up funds for growth in essential programs.

The time has come to reduce what has clearly become an excessive rate of growth in Federal spending and to move toward a balanced Federal budget.

Our other major domestic policy priority is to achieve meaningful tax reform legislation. The bill passed last year by the House of Representatives is a good start but not a final product. Our primary concerns are the following:

The bill lowers marginal tax rates but the top individual rate of 38 percent and the corporate rate of 36 percent are still too high;

The bill raises the personal exemption to $2000, but to only $1500 for taxpayers who itemize deductions;

The bill fails to maintain the cost of capital at sufficiently low levels to promote economic growth.

The Senate Finance Committee has begun consideration of tax reform and the Administration has pledged its full cooperation in improving the House legislation. Our major desired changes include:

Full $2000 personal exemptions for both itemizers and nonitemizers, at least for lower and middle-income taxpayers;

Provision of adequate capital cost recovery allowances and the protection of those allowances against inflation;

A top tax rate no higher than 35 percent.

Tax reform remains a top priority item on the President's agenda. We will work in a bipartisan spirit to achieve meaningful tax reform this year. But let me be very clear that the President will not compromise on matters of principle and he will not permit tax reform to degenerate into a tax increase in disguise.

CONCLUSIONS

The U.S. economy turned in a solid showing last year and the outlook this year is for stronger real growth without much increase in inflation. Internationally, as well, there was progress during 1985 and we will be working to build on that foundation. Our major domestic agenda items are reduction of an excessive rate of growth in Federal spending as we move toward a balanced budget, and meaningful tax reform for the American people. We think that both of these efforts deserve and will receive strong bipartisan support.

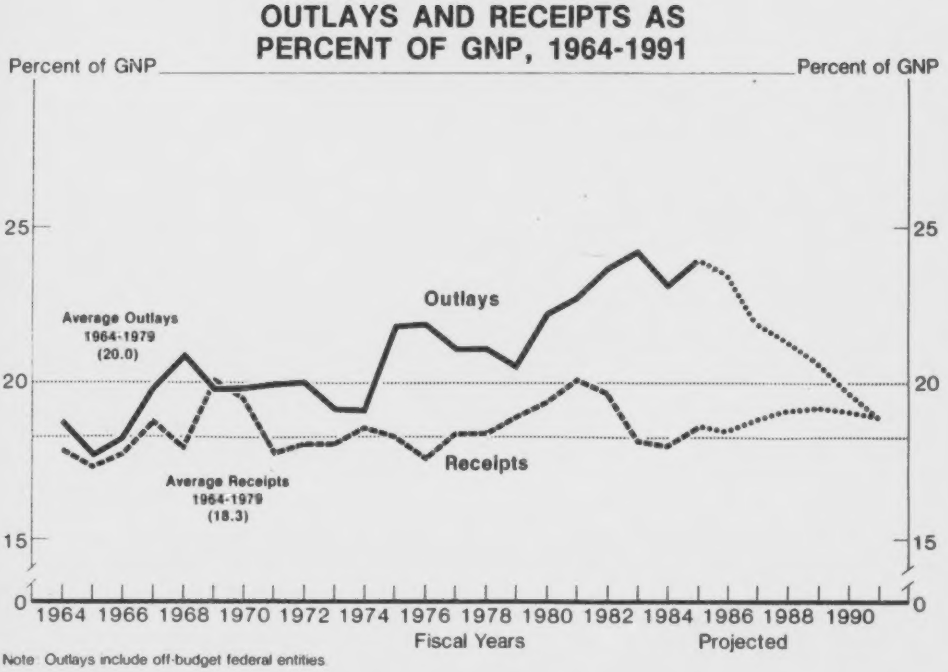
RECENT PROGRESS AGAINST INFLATION

(percent change, annual rate, during period indicated)

	1980	1981	1982	1983	1984	1985
GNP: Implicit price deflator	9.9	8.7	5.2	3.5	4.1	3.1
Fixed-weighted basis	9.8	8.5	5.0	3.8	4.2	3.5
Consumer price index	12.4	8.9	3.9	3.8	4.0	3.8
Producer price index (wholesale prices)	11.8	7.1	3.7	0.6	1.7	1.8

Note Fourth quarter to fourth quarter for GNP deflator, December to December for CPI and PPI

January 30, 1986 A41



OUTLAYS AND RECEIPTS AS PERCENT OF GNP, 1964-1991

Note: Outlays include off-budget federal entities

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Secretary Baker. I probably ought not attempt to respond to the question in your opening statement right off the bat. I probably ought to read my summary statement, but I won't do that, I will ask that it be incorporated into the record.

Let me see if I can answer the question. You ask how we can live with this budget without the Nation's financial condition becoming dangerous. My statement points out that our economy is in excellent shape today, and we have bright prospects for the future.

You have pointed out several areas of problems, and I would like to speak to those in a minute.

FY 1987 PRESIDENT'S BUDGET

You asked how we can live with our budget without the Nation's financial condition becoming dangerous, but if the Congress would pass the President's budget, it would vastly improve our fiscal condition, and economic situation, and bring the deficit into balance with no more policy changes required between now and 1991.

If we are willing to do the things that the President is asking us to do, we can see this budget balanced with zero deficit in 1991. For FY 1987, we are talking about $23 billion, Mr. Chairman, when you net it all out.

We are talking about $38 billion in reductions in order to get to the Gramm-Rudman target of $144 billion, but that is really $23 billion in domestic program reductions, that is domestic programs exclusive now of social security, which of course, is exempt from Gramm-Rudman.

I get the $23 billion in this way from $38 billion. We have $6.3 billion of revenue increases in the President's budget in the form of a continuation of the cigarette tax, user fees, Federal employee retirement contributions, and so forth, so that gets you down to $32 billion.

We then, I think it is fair to say, net out asset sales and privatizations because that is not a diminution of Federal services, and not a reduction in spending. It means we are going to let the private sector carry the load.

That gets you down from 32 to 27. Then if you net out the $1.2 billion in reduced interest on the debt, it gets you to roughly $26 billion, and of that $26 billion, $2.7 billion is defense, $2.7 billion is defense from the 1986——

Chairman **Whitten**. You call it defense when it is added to the carryover—you propose an increase in carryover of $57 billion of unspent funds. You are building that up continuously since 1975. We have been cutting out domestic programs and not putting the money on deficits, but increasing the carryover of unspent funds, and here again, you ask for an increase in the carryover.

The American people will sacrifice a lot to defense, but not to increase that unspent money to that level in my judgment.

Secretary **Baker**. I think it is fair we use the 1986 Congressional Budget Resolution. That is what I am doing when I say that there is a $2.7 billion reduction from fiscal year 1986. I think that is reasonable.

I would like to try and answer your question. Give us temporarily credit for that $2.7 billion, and that gets you down to $23 billion in domestic program reductions to balance the budget in 1991, assuming a number of things.

One, assuming we don't spend a lot more between now and then, and assuming that our economic assumptions are valid and justifiable, and the Chairman of the Council of Economic Advisers is here to speak to that.

What is $23 billion? It is a lot less than the $39 billion that the Congress reduced Federal spending by in 1981. It is roughly 5 percent of total domestic spending, exempting social security. It is 5 percent of all domestic spending, exempting social security.

It is $23 billion out of roughly $425 billion, or if you look at total outlays, it is $23 billion out of total Federal outlays of $1.027 trillion. So, I don't think that the task is something that we ought to write off as totally impossible right off the bat.

I think we ought to consider it, take a careful look at it, and see if we don't want to get to balance by doing what the President has suggested.

So, I would answer your question by saying that today, what the President has asked will improve our economic and fiscal condition, it won't cause it to become more dangerous, as your statement suggests.

You mentioned the fact that we are a debtor Nation for the first time in a long time, and that is true, and the consequences of that are not necessarily all bad. It depends on how we use the money coming here.

As long as we use the capital inflows for productive investment, income producing investments, I think they automatically tend to retire the debt and increase our national wealth.

We ought to try to avoid borrowing from foreign sources totally for consumption purposes. But one point in that regard, is that prior to this century the United States was a debtor nation for 200 years, as we prospered and expanded our frontiers, and invested our money properly.

You mentioned the trade deficit. It is unsufferable and not something that we can continue to live with.

But I don't think the way to attack the trade deficit is to walk away from the fiscal deficit. The way to attack the trade deficit is not to raise taxes, it is to cut Federal spending.

We have to do something for agriculture, and textiles and steel, but I will suggest that raising taxes is not the way to go. The way to go is to get a handle on the fiscal deficit.

We are talking about total revenues in this country today that are 19 percent of gross national product.

That is historically where they have been on average since 1964. Federal outlays, Federal spending, is 24 percent of gross national product.

So, I don't think it is a case of the American people being undertaxed, but that we are spending too much. It seems reasonable to me that we should look to the 1986 budget resolution which was an agreement between the legislative and executive branches.

The President's budget calls for an increase in defense of something less than three percent in real terms from that level.

Chairman **Whitten**. You have reference to outlays and budget authority, but where we can incur the debt, instead of paying for it adds some 12 and 13 percent. You are referring, if I read it correctly, to outlays, which may be in the neighborhood of three percent, but if you keep defense growing each year in a few years you won't have anything left to run the country.

Secretary **Baker**. We have to look at outlays because we are talking about a deficit.

Chairman **Whitten**. I agree; but we shouldn't ignore the other.

Secretary **Baker**. I agree; but I think outlays is the bottom line.

Chairman **Whitten**. Not if you have a debt you don't intend to pay.

Secretary **Baker**. I think the President's budget represents a very reasonable approach to balance by 1991, if we have the courage and the will to try and make it work.

We make a mistake, in my view, in simply saying right off the bat it is not workable, we can't go any further, we have cut spending all we can. I think the American people believe that there is plenty of room to reduce Federal spending further, Mr. Chairman, and when you look at the alternatives to cutting Federal spending they are the following:

Increasing taxes; cutting defense further; or taking a bit out of social security; and I don't think any of those are reasonable alternatives that any of us—certainly, they are not alternatives that we in the executive branch would be willing to accept.

Chairman WHITTEN. We like you and like your record, and admire your work. We could have understood this in '41 but that is what your precedessors told us in '41.

After five years experience going down hill as fast as we have, based on the same argument you make here, why don't you look at that and wonder if we don't need to change our course.

We were told in '41, cut out the windfall profits tax and let those folks that made money buy the IOU's that had credit coming, that will be fine.

I point out when we say gross national product, that includes the waste, and the more you waste the greater the GNP, which you cannot deny.

Secretary BAKER. Mr. Chairman, I am not saying the world is fine, but I am saying we are in the 39th continuously successive month of economic expansion. When this administration took office we saw interest rates at 21½ percent.

They are lower today than they have been in seven years, inflation is finally under control and has been for four years.

Chairman WHITTEN. They say I said 41 and it was 1981.

We have had five years experience and we are going down hill mighty fast.

Secretary BAKER. We have no alternative, the Congress has passed and the President has signed into law the Gramm-Rudman-Hollings amendment.

We can no longer write with red ink, neither of us. We have to do something about the deficit and fairly soon, and there are only two ways to do it, cut spending or raise taxes.

Chairman WHITTEN. The bill takes cuts from private to a military spending carryover.

Secretary BAKER. Our budget calls for cuts on the domestic side and an increase in defense of three percent in real terms. This is the agreement that the legislative and executive branches entered into last year.

We have a difference of opinion on how much we ought to spend next year on defense vis-a-vis domestic programs, and I acknowledge that, but the President is engaged in a process of trying to work out an agreement with the Soviet Union.

The worst thing we could do now is further cut defense beyond what we viewed as reasonable as of August of last year.

Chairman WHITTEN. In the 1960's Khrushchev and others said they had whipped the United States without firing a gun by making us spend ourselves into bankruptcy. Those were the exact words—every member of Congress in the 1960's was afraid that we would destroy ourselves with spending, and I don't know that they feel that bad reading about how much money we are spending.

It is not commitments by us, this Committee on Appropriations has proposed less than the President has asked, and not more, continuously.

Secretary BAKER. One thing and perhaps we should go to the other witnesses.

I think it is important to note that defense spending, Mr. Chairman, is roughly six percent of gross national product today. It is lower than it was in any peacetime year, under either the Johnson, or the Kennedy Administrations.

I don't think we are spending too much on defense. I suppose we can debate reasonable minds can differ on that.

My view is when it is at six percent and it is less than it was in any peacetime year in the Johnson or Kennedy Administrations we are not spending too much on defense.

Chairman WHITTEN. You have to come back and say not how much but whatever you needed to spend, whatever it took to defend. That seems to have gone out of style.

With our experience, you have had five years of a trial run, and it hasn't worked out, so I believe more strongly in my view than yours.

I have on my side the five years of experience which I have described here.

Secretary BAKER. I think if you look at the economy today, Mr. Chairman, we simply disagree on that. I think it has worked and worked pretty darn good.

Chairman WHITTEN. I would say quite lightly.

Secretary BAKER. I say it has worked well, and you disagree, and that is what makes horse racing, I suppose.

Chairman WHITTEN. Mr. Miller.

Mr. JAMES MILLER. Mr. Chairman, thank you for the opportunity to come and discuss the President's budget.

Like the secretary, I think I will offer a statement for the record, but, Mr. Chairman, if you don't mind, I would like to make a presentation of the President's budget using several charts that have been prepared.

Chairman WHITTEN. Be glad to have you do so.

PREPARED STATEMENT OF HON. JAMES C. MILLER III, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman and Members of the Committee, it is a pleasure to appear before you today to present President Reagan's budget for FY 1987. It is even more of a pleasure for me to be here at this time because of the economic expansion the country is now enjoying—one of the most vigorous in 35 years. Family income is at an all-time high; production and productivity are increasing; and employment gains have been extraordinary. Inflation, which raged at double-digit rates just five years ago, has been reduced dramatically. During the past three years, real GNP has grown at more than double the annual rate of the last three years of the previous administration. The prime rate of interest and other key interest rates are less than half what they were five years ago. Also, during the past three years corporate profits increased 117 percent and stocks nearly doubled in value.

I could go on and on reciting positive economic indicators. The point is that the economic recovery that began in 1982 is now in its fourth year, and the economic expansion need not end.

This dramatic turnaround in economic performance was not due to happenstance. Instead, it was a result of steadfast adherence to the economic program the President presented in February of 1981:

Restraining the growth of Federal spending;

Reducing tax rates;

Relieving the economy of regulatory excesses; and

Encouraging a sound and stable monetary policy.

Conditions are now favorable to a continuation of our remarkable economic expansion. However, we must take cognizance of one major threat looming on the horizon: the Federal deficit. If we do not do something about the deficit, we not only forego the heightened economic activity such action would bring, we run the risk of an economic downturn—a result that would be in no one's interest.

We simply cannot let this happen. Therefore, the President's budget has as its major objective getting the deficit under control and achieving a balanced budget by FY 1991. In so doing, this budget meets or exceeds the deficit reduction targets set out in the Balanced Budget and Emergency Deficit Control Act, commonly known as Gramm-Rudman-Hollings.

Last fall, there developed a bipartisan consensus to do something about the deficit. This consensus, which took the form of Gramm-Rudman-Hollings, committed both the President and the Congress to a reasonable, fixed schedule of progress. By submitting this budget, the President abides by the law and keeps his part of the bargain.

This budget shows, moreover, that eliminating the deficit is possible without raising taxes, without sacrificing our defense preparedness, and without cutting into vital programs for the poor and the elderly. A tax increase would jeopardize our economic expansion and thus could prove counterproductive in terms of its effect on the deficit. We cannot turn away from our responsibility to maintain a strong defense, especially now that prospects appear good for meaningful arms reduction talks. And we must not break faith with those poor and elderly who depend on Federal programs for their economic security.

The President proposes a FY 1987 budget with outlays of $994.0 billion and receipts of $850.4 billion. The budget proposals would thus hold the deficit to $143.6 billion—$400 million below the Gramm-Rudman-Hollings target for FY 1987. On a current services basis, outlays are estimated to be $1,025.9 billion and receipts $844.1 billion, resulting in a deficit of $181.8 billion. This is what the deficit would be without Congressional action and clearly it's too high.

In order to achieve the Gramm-Rudman-Hollings target, the FY 1987 deficit must be reduced by $38.2 billion below current services. The President's budget proposes that $6.3 billion of this amount come from higher government revenues. These receipts are a result of increased employee contributions to Federal retirement funds, initiatives by the Internal Revenue Service to collect more of the taxes already owed, and accepting the all-but-inevitable extension of the extra eight-cents-per-pack tax on cigarettes. An additional $3.2 billion comes from selling various real and financial assets. Increased user fees account for $2.4 billion in FY 1987, and reduction in the deficit will save some $1.2 billion in interest expenses. This leaves $25.1 billion which must be derived from programmatic reductions. Since $2.7 billion of this amount comes from reductions in defense funding—while still meeting the President's goal of a three percent real increase—only $22.4 billion of the $38.2 billion—less than 60 percent—must be obtained from cuts in nondefense areas.

The President's budget proposes to achieve the deficit reductions necessary to reach the Gramm-Rudman-Hollings targets by ending Federal activities that have outlived their usefulness; by transferring to State and local governments or the private sector those activities that they can carry out more efficiently; by eliminating Government competition with the private sector; by making appropriate changes in the scope of remaining programs, including the better targeting of social services programs; and by making the remaining Government programs more efficiently, more effectively, and with more accountability.

Let me give you some examples of the kinds of changes we are proposing.

Many Government programs have outlived their usefulness, represent an inappropriate area for Federal involvement, or simply generate benefits less than their costs. We plan to eliminate such unnecessary programs, including Small Business Administration credit programs, the Amtrak subsidy, Urban Development Action Grants, the Appalachian Regional Commission, the Economic Development Administration, the Interstate Commerce Commission, education subsidies for the health professions, the work incentives program, and air carrier subsidies.

Functions that properly ought to be operated at State or local levels include economic development assistance, and the non-farm part of the agricultural extension service. Also, the Federal Government should get out of the business of paying for local sewage treatment systems, local law enforcement, subsidies to local mass transit, State maritime schools, and local coastal management.

Commercial-type operations where it would be better for the Government to get out of the business and stop competing with the private sector lead us to propose the sale of the power marketing administrations and the Naval petroleum reserves. This budget also proposes the sale of unneeded assets, such as loan portfolios and surplus real estate, and contracting out appropriate Federal services.

This budget proposes reforms to limit the costs and improve the targeting of Federal programs that have become overextended, misdirected, or operate on too expansive a scale—such as medicare and medicaid, subsidized housing, Civil Service pensions and health benefits, postal subsidies, interstate highway grants, and the Forest Service.

Finally, those who receive special benefits and services from the Federal Government should be the ones to bear the costs of those services, not the general taxpayer. Accordingly, this budget imposes fees and premiums for Federal guarantees of loans, and imposes user fees and charges for Federal cost recovery of meat and poultry inspection, National park and forest facilities, harbor and inland waterway use, Coast Guard and Customs insepction, and for many other services.

Accompanying this budget is the administration's second report on management, the first signed by the President. The report describes the program that we call "Reform 88", which is this administration's effort to upgrade the management of executive-branch agencies. It summarizes the progress we have made in the areas of cash management and debt collection, and outlines future steps we will be taking to improve the management of Federal loan portfolios. It describes efforts to upgrade agency financial systems for both improved efficency and better control. Finally, it describes a comprehensive program which is expected to boost Federal productivity some 20 percent by 1992. This productivity initiative should yield not only cost savings, but significant improvements in program delivery. In general, the report indicates that sound business practices can be brought to bear on Government programs and yield positive results.

Despite the very tight fiscal environment, this budget provides funds for maintaining—and in some cases expanding—high-priority programs in crucial areas of national interest. Necessary services and income support for the dependent poor and the elderly receive significant funding in this budget. So do other programs of national interest—including drug enforcement, AIDS research, the space program, nonmilitary research, and national security.

While national security programs continue to be one of the President's highest priorities, they have not been exempt from general budget stringency. Last summer the President agreed reluctantly with Congress to scale back the planned growth of defense appropriations to a zero real increase for FY 1986 and only a three percent real increase each year thereafter. Congressional action on FY 1986 appropriations and the subsequent sequestration for FY 1986 under Gramm-Rudman-Hollings cut defense budget authority well below the preceding year's level in real terms. This budget would return defense funding to a study, well-managed growth pattern consistent with the program levels agreed to in last year's budget resolution and consistent with what the country needs in order to provide for our national security.

In summary, the President's budget provides adequate funding for vital programs for the poor and elderly, for our Nation's defense, and for other high priority programs, and yet meets the FY 1987 Gramm-Rudman-Hollings deficit target without raising taxes. Moreover, the President's budget meets all the Gramm-Rudman-Hollings deficit targets through FY 1991 without increasing tax rates in any year.

Mr. Chairman, I recognize how difficult it will be to make some of these cuts I have outlined here today and that are detailed in the budget document. Strong special interest groups exist to lobby for almost every Government program, no matter how inefficient, outdated, or irrelevant to the average taxpayer. Nevertheless, we need to take our "medicine" now and make the $25 billion in programmatic cuts for FY 1987. By doing so, we avoid both a FY 1987 sequester and additional cuts in later years to meet the Gramm-Rudman-Hollings schedule of deficit reductions.

The President's budget, through a combination of increased revenues, program terminations—many of them long overdue—, spending cuts, and other reforms, meets the $144 billion deficit target for FY 1987. Any alternative approach would attack the family budget by increasing taxes, would deteriorate our national security posture, or would break faith with the poor and the elderly.

The President's approach, I submit, is in the long-term interests of the American people. Accordingly, I urge you to support it throughout the legislative process.

Mr. Chairman and Members of the Committee: that completes my statement. I shall be happy now to address your questions.

Mr. JAMES MILLER. Thank you.

Mr. Chairman, I think the important things to remember about the President's budget is that it does lower the deficit by $38 million in Fiscal Year 1987, it complies with the Gramm-Rudman-Hollings targets that were passed by Congress overwhelmingly, not only from 1987, but to a balanced budget in 1991.

It avoids increased taxes and reflects a bipartisan consensus to protect social security, funds national defense at the levels agreed to between the Congress and the President in the 1986 congressional budget resolution passed last August, and it protects income support programs for the needy.

Mr. Chairman and members of the committee, this is a diagram of the total revenues coming into the Treasury for 1986 through 1991. It compares the current services level of revenues with the level of revenues that is incorporated in the President's new budget and as the Secretary pointed out, there is for 1986 some $6.3 billion increased revenue under this President's budget.

You heard a lot about the need for increased revenue. This is increased revenue, not only from the kinds of things that the Secretary talked about, the increased IRS agents obtaining taxes that are owed the government, but from a 2 percent increase in contributions by federal employees to the retirement program, and the extension of the extra 8 cent per pack cigarette tax. So there is revenue here and in the form of asset sales, user charges and privatization.

We save also a billion dollars in terms of lower interest rates, as I will mention later. Fully 30 percent of the budget savings that is incorporated in the President's budget are through increased revenues.

This characterizes the increase in current services outlays, and this is the increase in outlays under the President's budget.

As you can see, under the President's budget, outlays continue to increase throughout the period 1986 to 1991.

DEFICIT REDUCTION

This depicts the effects of the President's budget on the deficit. Here is the deficit at $225 billion estimated by CBO and OMB and calculated by GAO, and this is the current services deficit.

As you can see, even if we make no changes in policy we will get a diminution in the deficit ending in 1991 with something like $105 billion in deficit for the year.

This dotted line here represents the Gramm-Rudman targets beginning at 172, 144 for 1987, diminishing in 1991 at zero balanced budget.

The lower shaded area is the President's budget for Fiscal Year 1987. Down to 1987, we get to the 144, but every year beyond that the President's budget meets the Gramm-Rudman targets. This is important.

I have heard stories that terrible things are going to happen, and this is just the first year. The point is if we make the changes in policy that the President's budget incorporates, we don't have to go back to the well again. We don't have to go back to the doctor for more castor oil or however you want to characterize it.

These policy changes, assuming that our economic assumptions are correct and assuming we don't add programs, will get us a balanced budget by 1991.

This information is contained in the book that you have before you, the highlights book. These tables show that the President's budget has receipts that continue to grow throughout the period and outlays that continue to grow throughout the period, but the deficit comes down from 202.8 under the Gramm-Rudman sequester in 1986 to a very small surplus of 1.3 billion, a lot more money than I will ever see, but relatively speaking, a small surplus in 1991.

As you can see, also during this period of time, there are increased receipts under the President's budget, $6.3 billion for 1987 versus $31.9 billion in outlay reductions, and that, of course, also incorporates some offsetting receipts which are really revenues, that $31.9 billion figure.

Before I go further, I don't think taxes are the answer. Receipts, tax revenue for the period 1980 through 1986 have been roughly constant—they have jiggled around a mean, but the mean has been around 18 or 19 percent.

On the other hand, spending has had an upward trend, yielding the increase in deficit. So spending has been the problem, not taxes. The President's budget calls for a decrease in spending as a proportion of gross national product, a rather constant tax rate at the historical level of 18 or 19 percent, and accordingly, the difference between them going down the deficit will go down and be eliminated by 1991.

SOCIAL SECURITY

Nor do I think cutting social security is the answer. Under the President's budget, nominal outlays for social security, real outlays will continue to rise over this period of time, but as a proportion of gross national product, social security will slightly diminish but remain rather constant.

DEFENSE

Nor do I think, Mr. Chairman, that cutting defense is the appropriate way to go. As you can see, from 1982 through 1986, this was the original plan that the President hoped to project for the defense spending back in 1981 when he came into office.

This dot-dash line here is the nominal spending that President Carter recommended as he left office. The lower line, the shaded part, is budget appropriations for the Defense Department throughout this period of time.

As you can see, it has taken a nose dive since 1985. In nominal terms budget authority is below that recommended by President Carter as he left office.

Chairman WHITTEN. I said in my opening statement what you have done with defense has been you have cut down your request for increases; whereas, on the domestic programs you cut for real.

Mr. JAMES MILLER. But there is no getting around the—

Chairman WHITTEN. If you look at it, your request for defense increases were reduced but on the domestic side you really reduced.

Mr. JAMES MILLER. However you look at it, nominal or real budget authority has turned down for 1986. And, if you look in real terms, while budget authority rose over the period 1982 through 1985, it took a down-turn in 1986, partially because of the Gramm-Rudman-Hollings sequester. But as you can see, in real terms budget authority is back at approximately the same level as existed in 1984.

Chairman WHITTEN. I don't mean to point out, but if I may, we have a necessity for a budget agreement, and the House went along with a $10 billion addition for defense proposed on the other side of the Capitol so that they could go in debt.

So that, we could say we had agreed on a budget, we had to give $10 billion of indebtedness.

What we have here are the cuts that you have got in domestic programs that the people think are essential, revenue sharing and others, not to go to the deficit, not to go to reducing the debt, but to increase the carryover to $299.7 billion for military spending which could be different from defense.

Mr. JAMES MILLER. As you know, you appropriate budget authority, and the spend-out rate for defense tends to be a lot lower.

Chairman WHITTEN. But you see what kind of a fix we are in as a result of it.

Mr. JAMES MILLER. Mr. Chairman, I respectfully disagree that that is the problem. On the other hand, if you look at the President's—what the President asked for in his budget of '86 for defense budget authority, it was continuing to rise here. What the Senate-House Congressional budget resolution of last August described for defense, where the President freed for 1986 for zero real increase in defense, that was this line here.

As you can see, over a five year period there is a $290 billion difference between those two numbers. In other words, the budget resolution the President agreed to is considerably less than what he asked for in FY 86, so it can't be said that the President hasn't revised downward his request for defense spending.

Finally, let me say, Mr. Chairman, even taking the Congressional budget resolution of last August as a starting point, the upper line here, the President's 1987 budget asks for a lesser expenditure—lesser appropriations for defense during this period. Why? Well, we looked at the defense spending and considered that the Defense Department could get along with less money and still get a three percent real increase in defense effectiveness. We also lowered the special inflation factor from 1.3 to 1.0 and this means that since every year the inflation factor and the base will be lower sequentially as you go out in years, there is a wedge effect and over the next five years because of the revisions in the current budget, there will be a savings of $45 billion in budget authority.

Now, Mr. Chairman, I have a problem. I am standing in the way and I wish I were skinnier for this reason and others. What I have portrayed on this side, Mr. Chairman, and members, is the expenditure line, the gross outlays for current services. As you can see, it rises through the period '86 to '91 and it is broken down by major components, net interest, the proportion that goes to national security, that proportion going to national defense and all other programs.

On this side we have the same thing except under the President's budget. Eyeballing it, it looks very similar. As you can see, the breakdown is exactly the same. The slope of the line is a little less. Since we are not going to realize savings from social security and for reasons that are apparent, though I will make a slight comment about it, we are not saving the money from interest, we have to pay interest.

We are making some savings in defense expenditures. We need additional savings, additional savings since there is $6.3 billion in revenue and $38 billion is the amount that we have to save in order to reduce the budget deficit, which we estimate to be $182 billion down to the level of $144 billion. We are looking at that lower level, that lower part of the graphs that I just showed. I would like to break those down for you. About $400 billion, over 40 percent of the federal budget, is in this area. You can divide that into three groups, income support, major medical and retirement and benefit programs and essentially all other government activities.

This is the grant for current services starting just above $400 billion. Here is the same thing under the President's proposed budget. There is some diminution in the top line for '87 but it rises again throughout the period of the next four years.

CURRENT SERVICES VS. 1987 BUDGET

Now, what I would like to do, Mr. Chairman, is put up graphs that look at each one of these three component parts and compare current services with the President's proposed budget. Mr. Chairman and members of the committee, this is a depiction of the low income support part of the budget and it is broken down into major component parts—AFDC, food stamps, SSI, WIC, BAA and pensions and other programs. It is approximately $40 billion of the national budget, ten percent of the $400 billion which is 40 percent of the total, and just eyeballing the two, the current services baseline and also the President's budget, you see that they are very similar.

The reason is the President wants to protect these low income support programs for the poor. There are only $700 million savings out of $40 billion in baseline for 1987 from these programs, and we are saving this money in such a way that our plan is not to reduce the services afforded to the low income people.

Now, let's look at the second part of that group, the major medical retirement benefit programs. This is civil service retirement, veterans income security, unemployment compensation, medicare and medicaid. Here you see the current services baseline. Starting at $190 billion, it moves upward, a substantial increase in expenditures, but the same thing is true of the President's budget. It starts at a little lower base but there are substantial increases over the five year period.

Again, this five year period is one in which the deficit will go to zero by '91. For '87 there will be savings of less than $10 billion, again off of the base of approximately $190 billion—so that is around five percent.

This chart looks at all other activities: transportation, energy, law enforcement, education, health, et cetera. As you can see, this is the area in which there are the more substantial reductions. In time of fiscal tightness, it was viewed by the President that these were the activities with the lower priority, thus saving the low income, elderly, and defense programs and also avoiding a tax increase.

As you can see, this remains roughly constant under current services. Under the President's budget it drops here, remains reasonably constant and lowers slightly over the period of five years. A total of $15 billion would be saved off a base of $180 billion for '87, which is again less than ten percent. And in keeping with this, I find it interesting that sometimes people are very concerned about these proposals. Some of these reactions I guess were based on rumor, not on fact, that Armageddon is at hand because of these cuts. In each of these areas the cuts have been less than ten percent, as you can see.

The final chart shows the sources of these reductions. Again, we are having to save $38 billion for '87, producing the savings in the outyears but for '87, a total of $38 billion of savings not counting the $6.3 billion in desirable revenue. As you can see from my description, before there is a savings wedge here for national defense because the amount of money asked for by the President is less than that contained in the congressional budget resolution. There is also a savings of net interest. Why? Because with a lower deficit there is less debt to service and debt service expenses will be lower.

Secondly, we expect under Gramm-Rudman, because a reduction and the uncertainties created by the deficit and crowding out that might be going on, a lower rate of interest and a lower nominal rate of interest and this gets us a savings wedge which accumulates every year. As you heard, the President's budget incorporates certain increases in user fees, asset sales and privatization. This generates revenue. Here we have only the undistributed receipts. There are distributed receipts of about the same amount that are revenues, not expenses, so this blue area here represents the maximum real program reductions that are incorporated in the President's budget. Again, if I could recapitulate, only $23 billion as the Secretary said, only $23 billion of savings—only $23 billion of the $38 billion in savings—only 60 percent. Sixty percent are actual reductions in domestic programs, including social security, because there is no reduction in social security.

Chairman **Whitten**. We have to interrupt but we do have a roll call.

Mr. **James Miller**. I am finished. Thank you.

[A short recess was taken.]

Chairman **Whitten**. Mr. Miller, have you concluded with the graphs?

Mr. **James Miller**. Yes, Mr. Chairman, I have.

Chairman **Whitten**. I will yield to Mr. Sprinkel at this time. He has to catch a plane. We are required to have this hearing by law and if he could be heard at this time, when you have to leave, we will understand.

Mr. **Sprinkel**. Thank you, Mr. Chairman.

I had intended to discuss in some detail why our confidence is very high that the economy will perform well. Unfortunately, due to the commitment I made to Senator Garn some weeks ago, I will have to leave very shortly, but let me give you, if I may, the bottom line and invite you to submit questions. I certainly will be pleased to respond.

We are quite confident, based on not only leading indicators of economic activity, but also in terms of what has actually been happening in production, employment, output in recent months, that we will in fact attain our objective of a four percent growth fourth quarter to fourth quarter.

ECONOMIC FORECAST

We have long term projections based on long term trends. It is not a forecast, it assumes policy objectives are achieved. The most important is the Gramm-Rudman objective of getting the budget down toward zero deficit by the period of 1991. We believe that the net effect of Gramm-Rudman-Hollings bill will be a strong plus on economics, that we will be able to create more jobs, better growth as a result of permitting resources to move very slowly from the public to the private sector. We are convinced that it will not induce a recession, since the shift of resources is gradual.

So, my final conclusion is the economic prospects are good and if the Congress and the Administration can achieve Gramm-Rudman-Hollings targets they will be even better.

Thank you, sir.

Prepared Statement of Hon. Beryl W. Sprinkel, Chairman, Council of Economic Advisers

Chairman Whitten, Representative Conte, and distinguished members of this Committee, it is a pleasure to testify this afternoon concerning the Administration's economic forecast for 1986, its economic projections through 1991, and the assumptions about economic policy that underlie this forecast and these projections.

The American economy is now in the fourth year of a robust expansion that has already increased employment by more than 9 million and sustained the greatest advance of business fixed investment of any comparable period since World War II. Inflation remains at less than one-third of the rate when President Reagan assumed office. Interest rates are down between five and ten percentage points from their peaks in 1981, and most interest rates are now at their lowest levels in more than six years. The stock market continues to register new highs.

Important problems remain for the American economy. The 3.8 percentage point drop in the unemployment rate since November 1982 is the largest decline for a comparable period since 1949, but the unemployment rate remains too high. Agriculture and some of our manufacturing industries face serious problems. The trade balance shows a large deficit. Federal spending continues to consume an unacceptably large share of our Nation's resources. Productivity growth has recently fallen off from the rapid rate recorded during the early stages of this expansion. With appropriate economic policies, however, these remaining problems can be resolved, especially in an environment of rapid and sustainable economic growth that the Administration forecasts for 1986 and projects on a longer-term trend basis through 1991.

THE FORECAST FOR 1986

Real growth was somewhat below forecast in 1985, but many indicators point to acceleration of real growth in 1986. Money growth over the past year has been ample to fuel more rapid expansion of economic activity in the face of continued moderate inflation rates. The leading indicators have been up for 11 out of the last 12 months, including a 0.9 percent rise in December. The drawdown in inventories which inhibited output growth in 1985 has led to low inventory/sales ratios that should stimulate output growth in 1986. Personal income and expenditure rose rapidly in December. The decline in the dollar since last February should provide some stimulus to exports. The trade balance may worsen slightly in the first half of 1986, but should begin to turn around by year end. Stronger growth in Western Europe should contribute to this result. Lower interest rates and higher profit rates should provide increased stimulus to both residential and nonresidential fixed investment. Increases in consumer net wealth and real disposable income should keep real consumption expenditures growing. Increased revenues and already existing surpluses will probably fund increases in real spending by State and local governments. Even with a modest reduction in real Federal spending under the pressure of deficit reduction, there is no threat to continued expansion in 1986.

More specifically, the Administration forecasts that real GNP will rise 4.0 percent on a fourth-quarter-to-fourth-quarter basis between 1985 and 1986, and by 3.4 percent on a yearly average basis. On a fourth-quarter-to-fourth-quarter basis, employment is forecasted to rise by 1.7 million, a 1.5 percent gain over 1985, and productivity (output per hour) is expected to rise 1.8 percent. The unemployment rate is forecasted to show only a modest decline, to 6.7 percent by the fourth quarter of 1986, but we may well achieve better results in this important area. Housing starts are expected to rise to 1.9 million units by the fourth quarter. Relatively high money growth and the depreciation of the dollar during 1985 are expected to contribute to moderately higher inflation in 1986: On a fourth-quarter-to-fourth-quarter basis, the GNP deflator is expected to rise 3.8 percent, versus 3.2 percent on that basis for 1985. Lower oil prices will tend to moderate measured inflation and stimulate real growth.

LONGER-TERM PROJECTIONS

The Administration's longer term economic projections for 1986 through 1991 are summarized in the attached table. Except for 1986, the figures in this table should not be interpreted as point forecasts of expected results for individual years, but rather judgments concerning achievable longer term trends under appropriate economic policies. For real GNP the projection is a growth rate of 4.0 percent in 1986 and 1987, tapering off to 3.5 percent in 1991, for an average annual growth rate of 3.8 percent over the six-year projection horizon. As illustrated in the attached chart, this projection does not imply extraordinary or unprecedented real growth. Indeed, the projected path for real GNP gradually approaches, but remains below, the postwar trend path of real GNP fit through the cyclical peaks of 1948 and 1981.

The inflation rate, as measured by the GNP deflator, is projected to rise modestly above its 1985 level in 1986 and 1987, and then decline gradually (under the effect of a gradual reduction in money growth rates) to reach 2.0 percent in 1991. The unemployment rate is projected to decline steadily to 5.5 percent by the fourth quarter of 1991. Lower actual inflation and greater confidence of lower future inflation are anticipated to contribute to lower interest rates, with Treasury bill rates falling to 4.0 percent and ten-year government bond rates falling to 4.5 percent by 1991.

POLICY ASSUMPTIONS

The Administration's forecast for 1986 and especially its longer term economic projections are conditional on critical assumptions concerning economic policy. First, we assume that the Federal Reserve will gradually reduce the rate of monetary expansion at a pace that avoids both resurgence of rapid inflation and disruption of real economic activity in the shorter term, and that is consistent with price stability in the longer term.

Second, we assume that the Congress will enact tax reform similar to the President's Tax Proposals for Fairness, Growth, and Simplicity. Tax reform that reduces marginal tax rates for individuals and businesses and reduces disparities among tax rates for different types of investment is vital to provide incentives for vigorous economic growth.

Third, we assume that the Federal deficit will be reduced in accord with the targets established by the Gramm-Rudman-Hollings Act by imposing necessary restraints on Federal spending—not by raising taxes. Federal spending, no matter how it is financed, measures the resources that the Federal Government extracts from the economy—resources that frequently can be more efficiently employed in the private sector.

As a share of GNP, Federal spending has grown from 18 percent in 1960 to 24 percent today, while the share of Federal revenues has remained nearly constant (except for a brief rise in 1980–81) at around 19 percent. Reducing the share of Federal spending in GNP to that of Federal revenues will free resources to support private investment that will contribute to growth of output, employment, and labor productivity. Resources will also be freed to produce domestically some goods now imported from abroad and to produce exports to sell to the rest of the world, thereby contributing to an improved trade balance. Lower interest rates that will further stimulate economic growth may result from allaying concerns of higher future tax rates or of renewed inflation resulting from future efforts to inflate away the real value of government debt. In contrast, meeting deficit targets through increased taxes would distort and diminish incentives to work, save, and invest, thereby inhibiting economic growth.

Some fear that reducing government spending to meet the deficit targets of Gramm-Rudman-Hollings may cause a recession. Such fears are unjustified. The targets can be met primarily by holding down the growth of real government spending, rather than cutting its level. In fact, the only significant cut in real government spending is equivalent to about 0.5 percent of real GNP and occurs between the 1986 and 1987 fiscal years. Six times in the past 35 years real spending cuts of more than twice this relative magnitude have been made, without evidence that they led to recessions. Moreover, the required spending cut will occur when expansionary economic forces appear likely to be relatively strong.

In summary, the economy has performed well under the economic policies proposed and carried out by the Administration, enacted by the Congress, and conducted by the Federal Reserve. For 1986, the prospect is for 4 percent real growth and for only a modest increase in the inflation rate to 3.8 percent. Over the longer term, with appropriate economic policies, we can achieve the goals we all share: strong growth, high employment, and price stability.

ECONOMIC PROJECTIONS FOR 1986–91

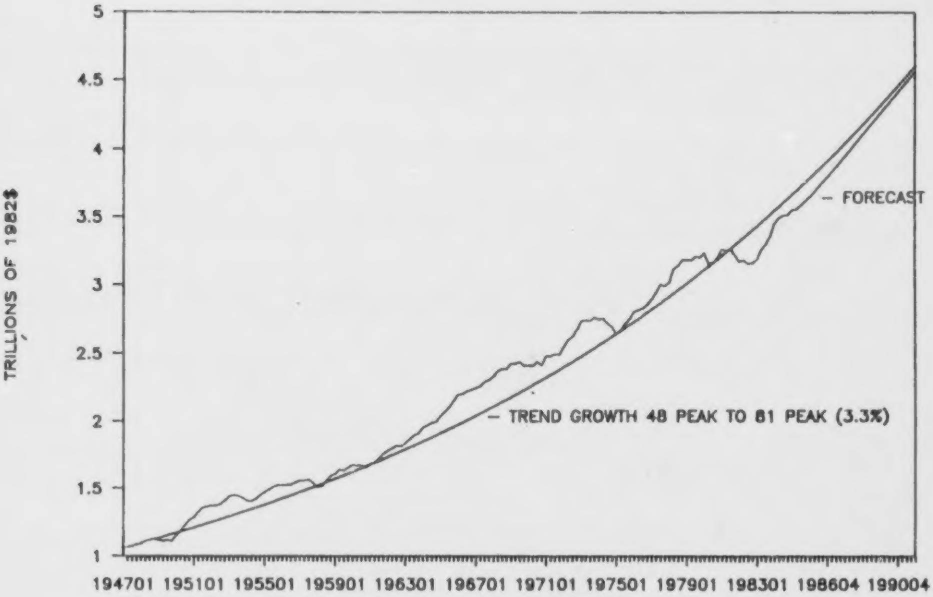
[Percent change]

Calendar year	Real GNP		GNP deflator	
	Year/Year	IVQ/IVQ	Year/Year	IVQ/IVQ
1986	3.4	4.0	3.5	3.8
1987	4.0	4.0	4.2	4.1
1988	4.0	4.0	3.7	3.6
1989	3.9	3.7	3.3	3.2
1990	3.6	3.6	2.8	2.5
1991	3.5	3.5	2.1	2.0

[Percent]

	Total unemployment rate		91-day treasury bill	
	Average	IVQ	Average	IVQ
1986	6.7	6.7	7.3	7.2
1987	6.5	6.5	6.5	6.1
1988	6.3	6.2	5.6	5.3
1989	6.1	6.0	4.8	4.5
1990	5.8	5.7	4.3	4.1
1991	5.6	5.5	4.0	4.0

REAL GNP AND TREND



COUNCIL OF ECONOMIC ADVISERS

Chairman WHITTEN. Let me point out a few things. At the time the conference on Gramm-Rudman was completed I pointed out that all of this is based on assumptions. You can change the assumptions and come up with any answer. I am proud to say that our Committee got them where they cannot cut out programs, projects or activities.

I think you would like to know that we are accustomed to economists. Most companies of any size have economists, but I never heard of them turning it over to economists to run. The point I wish to make, is that five years experience shouldn't be ignored in coming up with what we think will work next time.

I yield to the gentleman from Massachusetts.

Mr. CONTE. I hope you are halfway right and we will be in good shape.

Thank you, Mr. Chairman.

I want to join you, Mr. Chairman, in welcoming the distinguished panel here today, Secretary Baker, Director Miller and Chairman Sprinkel. Certainly the positions that they hold are very very difficult ones and I know that we all appreciate the tremendous effort they are making to put the federal budget in order.

GRAMM-RUDMAN

As I have said many times before, and this is not criticizing our witnesses here, I think that the Gramm-Rudman legislation was a mistake. I spoke against it on the floor. I happen to like the House of Representatives and feel that we certainly are turning a lot of our responsibilities over to computers and bean counters. I think that the law is unconstitutional, and I understand that tomorrow we will have a court ruling on that question. I was one of the 11 who brought suit.

But apart from that, I think that Gramm-Rudman represents congressional refusal—and Mr. Baker is right, it passed by a very large margin—to face up to the very difficult question of setting budget priorities and making cuts that are necessary. Instead, it relies a lot on across the board meat axe cuts that hack away on worthy programs along with the ones that are not so worthy and despite what I know are the best efforts of many, I think this was a very bad approach.

What I anticipate is that we will be seeing real chaos in August and September when we see the extent of the Gramm-Rudman cuts facing both defense and non-defense programs. I hope that we will be able to achieve a budget that meets our genuine needs in this country, defense and non-defense needs, and provide for an adequate level for both these areas and provide the revenue that is going to be needed to finance those objectives.

Mr. Sprinkel has shown us his charts. They show that we are going to get some revenue in the budget submitted by the President. Most of those things have been trotted out before. Last year I filed a bill to provide users fee for the Coast Guard. I couldn't even get a co-sponsor. When I testified before the Mercant Marine Committee for the bill, I couldn't get one person on the committee, Democrat or Republican, to give me a vote to report it out. That holds true in a lot of other areas that I am speaking of.

Congress has been quite generous with appropriations for defense. Since 1981, we have appropriated $1 trillion $449 billion for defense functions. In 1980 the budget authority for DOD was $140.7 billion. In 1986 it was $278.4 billion. That is a doubling of funds for DOD since 1980.

COMMODITY CREDIT CORPORATION

Let me ask a couple of questions. One is very pertinent. This afternoon we passed a $1.5 billion urgent supplemental for the Commodity Credit Corporation. That is enough money to get us through this month if we are lucky. They are spending about $75 million a day on CCC, and this is going to take care of it until we get back from the recess.

Your budget estimates reflect a need for reimbursement for FY 86 totalling $7.95 billion. Is that still a true, accurate statement?

Mr. JAMES MILLER. Yes, it is.

Mr. CONTE. And if we don't give you $7.95 billion based on the new farm bill law that we passed, what happens?

Mr. JAMES MILLER. I understand that the CCC would not be able to function.

Mr. CONTE. How long will that $7.9 billion carry you?

Mr. JAMES MILLER. It is my understanding through the end of the fiscal year.

Mr. CONTE. You won't be up here again if somehow or other we can get it again?

Mr. JAMES MILLER. That is our best estimate.

Mr. CONTE. What do you think the CCC reimburesments will be in 1987?

Mr. JAMES MILLER. I don't have that figure.

Mr. CONTE. Have you been able to make a further analysis of the costs of new farm bill?

Mr. JAMES MILLER. Of the farm bill? Oh yes, we came in at something like $53 billion over three years. The outlays for FY 87 are approximately a third of that, a little less than a third of that, as a matter of fact.

Mr. CONTE. Among the FY 86 supplementals you requested do you see anything for food stamps? Is $11.8 billion for food stamps enough for FY 86 or are we going to need a supplemental in that particular area?

Mr. JAMES MILLER. We do not anticipate another supplemental for that.

OIL IMPORT FEE

Mr. CONTE. Secretary Baker, many economists have criticized proposals for oil import fee because it would raise business costs and make America's products less competitive in world markets because oil is a basic input to so many industrial products and processes.

An import fee will also introduce a new inflationary influence in the economy, plus the fact that 80 percent of the oil used in the Northeast is imported oil, and the other reason that I would oppose an oil import fee is that the domestic oil companies would bring their prices up to the imported oil fee, which would give the oil companies a tremendous windfall.

Have you taken any position on this?

I get a little nervous because I read the papers and I don't believe everything that is in the newspapers but there is a lot of ink out there recently.

Secretary BAKER. No sir, the Administration has not taken a position on it other than the President has said that he would not close the door on consideration of an oil import fee in the context of a revenue neutral tax reform bill, but only in that context. The President has not subscribed to it. He has not said that he would support it. He has said that he would consider it if it were necessary to get a tax reform bill of the nature that he supports.

Mr. CONTE. Well, if that day comes, I hope that the Administration would look at something more equitable for the Northeast; Maybe an energy tax across the board or an increase in the gasoline tax that will be spread evenly across the country.

Secretary BAKER. His position on a gasoline tax is exactly the same, Mr. Conte.

Mr. CONTE. For the past few years, Mr. Miller, the Treasury bill has been plagued with a proposal by the Administration to zero out the federal postal subsidy for nonprofit mailers and then finance the revenue foregone through other mail users. The budget claims that most existing subsidized mailers will continue to use the subsidy yet last year no legislation was ever passed in either the House or the Senate. It is really unfair to mislead nonprofit organizations when there is no effort by anyone to make this plan work.

What is the situation on that this year?

Mr. JAMES MILLER. Well, I do not recall—I was not here last year. If we have asked for that then we will surely propose legislation to carry forward whatever remedy we have, we proposed.

Mr. CONTE. According to the authorizing legislation, the postal subsidy is at the final phase-out step and I assume by this proposal that the Administration supports extending the program beyond the final step 16. Is that correct?

Mr. JAMES MILLER. I do not know the answer to that. I will get it for you in writing.

[The information follows:]

No. The Administration's proposal does not assume that the subsidized mailers would pay postage costs in excess of their attributable costs (i.e., step 16).

Although the budget proposal would terminate the Revenue Forgone Appropriation, most of the currently subsidized mailers would continue to receive a postal subsidy. The proposal simply shifts the burden of the postal subsidy away from the American taxpayer to the postal ratepayer—the direct user of the mail.

Mr. CONTE. Let me ask you one other questions. Does the budget reflect a freeze in the SLUC review cycle for any federal agency?

Mr. JAMES MILLER. I think there are some freezes in SLUC.

Mr. CONTE. It seems on the surface an easy way to save money would be to freeze that or reduce the rent paid to GSA for office buildings.

Mr. JAMES MILLER. It is an interagency transfer. It wouldn't save in outlays. It would not be a net saving.

Mr. CONTE. You know, if this practice continues, and I am afraid it is going to, it could severely threaten the integrity of the Federal Building Fund. Do you agree with me?

Mr. JAMES MILLER. Yes.

Mr. CONTE. Thank you, Mr. Chairman.

[The following questions from Mr. Conte were submitted for the record. Responses were provided by the Office of Management and Budget.]

Question. I understand that Senator Domenici has indicated that he believes supplementals in fiscal year 1986, like those in future years, can only be considered if offsetting reductions are made in other programs under the requirements of that piece of work called Gramm-Rudman. Would you indicate what your position is on the need to offset supplementals for fiscal year 1986?

[Additional material to be submitted to the Committee for the record.]

Question. Gramm-Rudman requires that we reduce the $200 billion deficit to zero by 1991, primarily through the sequestration process. Half that reduction, approximately $100 billion, is to come from defense, which has a base subject of sequestration of about $160 billion. The other half, $100 billion, is to come from domestic programs that have a base subject to sequestration of approximately $100 billion. Obviously, if Gramm-Rudman is implemented to provide a balanced budget by 1991, it will terminate most of the Defense base and just about all of the domestic base of programs subject to sequestration. Is the administration in agreement with the priorities of Gramm-Rudman to accomplish a balanced budget by wiping out defense programs and such domestic programs as nearly all of the Education Department, health programs such as maternal and child health, vaccines for our children, job training, meals for elderly, and so on and so forth?

[Additional material to be submitted to the Committee for the record.]

Question. I noticed that there's a supplemental request of about $1 billion for the default of the Great Plains project in North Dakota.

Does the Government have any other obligations that would require future appropriations?

How will we dispose of the project? Are there any serious buyers?

[Additional material to be submitted to the Committee for the record.]

Question. One of the most promising proposals in this budget is the plan to get a decent price for federally owned resources—in the defense stockpile and in the timber and minerals program. The effort to raise revenue is commendable, but I don't think the budget goes far enough.

The Government is losing millions and millions each year on timber sales. Only one Forest Service region is really getting our money's worth in timber on Federal land. Have you considered any reforms to the timber program in order to increase Federal receipts?

[Additional material to be submitted to the Committee for the record.]

Question. Why didn't the Administration propose to increase grazing fees on Federal land? OMB just asked for a freeze for another year instead of increasing the undervalued fees.

[Additional material to be submitted to the Committee for the record.]

Question. Mr. Miller, my understanding was that the Administration would seek a three percent real growth in defense spending for fiscal year 1987. My question is why the Coast Guard has not shared in this increase, especially given the Coast Guard's new Coastal Defense responsibilities, and the need to make the Coast Guard capable of serving as a part of the Navy in case of war or other national emergency. In fact, page IR-46 of the Budget Appendix shows that the Coast Guard's program level will actually decline by some 2.5 percent between 1986 and 1987. Why is the Administration continuing to short change the Coast Guard?

[Additional material to be submitted to the Committee for the record.]

Question. Despite the assumption that we would see a request for a 3 percent real growth in defense spending, the budget calls for a 14 percent increase in spending for the Department of Energy's defense activities, primarily for nuclear weapons research and production. This amount includes the recovery of Gramm-Rudman reductions. How do you reconcile this discrepancy, and how do you explain the effort to recover Gramm-Rudman reductions? Isn't that effort contrary to the spirit of the Gramm-Rudman process, which was endorsed by the Administration?

[Additional material to be submitted to the Committee for the record.]

Question. One of the anomolies of the Gramm-Rudman process is the reduction of expenditures by the Panama Canal Commission, which will result not in a reduction of the federal deficit, but in an additional $18 million payment to the Government of Panama. Mr. Miller, does the Administration intend to propose a supplemental to take care of this situation?

[Additional material to be submitted to the Committee for the record.]

Question. At a time when all non-defense spending is under severe pressure in the 1987 budget, I was surprised to see that the Corps of Engineers was scheduled for a 13.7 percent increase, and the Bureau of Reclamation scheduled for a 14.4 percent increase in 1987. Could you explain the considerations that went into the setting of those priorities?

[Additional material to be submitted to the Committee for the record.]

Question. If, according to your explanation of the budget, Jim, programs providing necessary services and income support for the elderly are "high priority programs" which should be "adequately funded", why have you proposed the immediate termination of new Section 202 loans for the construction and rehabilitation of housing for the elderly and handicapped?

With Section 8 subsidies, this is one of the most worthwhile and effective housing assistance programs that we have. How do you propose that we expand and improve our housing stock to meet the growing needs of our senior citizens, especially our frail elderly?

I've been working with a deserving community in my District, the Town of Southampton, for over a year now on a competitive 202 application. I was greatly disappointed to learn that it was not approved last year, but we hoped to resubmit it in the FY86 round. If the Congress rejects your supplemental langauge and rescission requests for the Section 202/8 program, will HUD have adequate time to complete an FY86 program for about 12,000 units?

[Additional material to be submitted to the Committee for the record.]

Question. I find it hard to believe that you're requesting a $5.2 million rescission of FY86 elderly feeding program funds. This Congress rejected your last budget request for a cap on program funding at $120 million, and provided $136 million for this fiscal year. I understand that the sequestration will reduce program levels by about $5.9 million. What is your justification for a $5.2 million rescission, and how would this impact the number of meals served in this Fiscal Year?

[Additional material to be submitted to the Committee for the record.]

Question. I see that, once again, you've proposed the termination of Farmers Home rural housing programs. Moreover, you've requested a substantial rescission and supplemental langauge to virtually eliminate the program in this fiscal year. The budget indicates that HUD will take care of rural as well as urban housing needs, even though its budget is being slashed by about 70%.

You want to give low-income rural families and poor young struggling mothers vouchers to use in Western Massachusetts. Well, perhaps you'd like to come on a tour of my District and point out the glut of safe, decent rental units in Royalston or Cummington or Peru or Petersham where these vouchers can be used.

What kind of commitment are we making to rural Americans in 1987 if we adopt these budget requests? How is a town like Chester going to compete against a Chicago, Boston or Los Angeles for housing and development funds? How can it compete against most of the "non-metropolitan" communities for HUD's attention?

[Additional material to be submitted to the Committee for the record.]

Question. Please provide for the record your estimates of the cost of the 1985 Farm Bill. Have your estimates changed from those made in December? How? Do you propose to send up any legislation to amend any of the 1985 Food Security Act's provisions?

[Additional material to be submitted to the Committee for the record.]

Question. With further regard to the CCC, Jim, the Department of Agriculture cites a need for $8.8 billion in reimbursements for net realized losses. That figure will probably climb again before the year is over. You knew and we knew that CCC would need $10 billion more than your FY86 estimate way back in September. Why didn't you send us an official supplemental request for the money before February 3, 1986 after the Corporation ran out of money?

Since our Committee and this Congress have refused to provide your request for permanent, indefinite authority, why don't you send us a straightforward request for the specific dollar amount that you need?

What is your position on the provision of current, indefinite authority for FY86?

Please provide for the record your best estimate of the need for reimbursements in FY87. Is this the same as USDA's projection? I certainly hope that you will inform our Committee in a timely manner of the CCC's supplemental funding needs, Jim, so that we can meet our obligations first and then work to reform some of the wasteful subsidy programs that contribute to these extraordinary urgent supplementals.

[Additional material to be submitted to the Committee for the record.]

Question. Your requests for assisted housing, community development block grants, urban development block grants and revenue sharing speak for themselves. This Committee and this Congress will handle those requests in the course of our normal hearing, budget, authorization and appropriations processes.

But, you have also proposed some significant rescissions, deferrals and supplemental loan limitation reductions for funds which we had already reduced in November in order to get a separate HUD appropriations bill signed into law. You found our agreements acceptable. The President concurred. I bit the bullet, along with my colleagues, and went home to report on these negotiated reductions. Local and state governments revised their budgets in the past month to reflect the federal cuts. They are going to have to revise them again when the sequestration order takes effect 23 days from now. They've had more revisions that they can handle. Now, with the fiscal year half over, you're asking them to take another 13% cut in CDBGs, to throw away their leveraged UDAG development commitments, and to cut by another 20% all of their police, firefighting and community services funded through the revenue sharing program. How are rural and urban communities across America going to make it through FY86? Their budgets, like ours, aren't worth the paper they're written on, anymore. If we take final action—for the second time—restoring these FY86 development programs, can the Administration make all this funding available to eligible recipients by September 30th?

[Additional material to be submitted to the Committee for the record.]

[The following questions from Mr. Conte were submitted for the record. Responses were provided by the Department of the Treasury.]

SOCIAL SECURITY TRUST FUNDS

Mr. Secretary, I know you'll be surprised, because you've heard me ranting and raving ever since Congress passed Gramm-Rudman, but there was one part of that package that I supported.

When the debt ceiling was finally raised last year, one of the victims of the long delay caused by Gramm-Rudman was the Social Security Trust Fund. In order to make payments to beneficiaries, Treasury redeemed securities held by the Fund earlier than usual, causing the Fund to lose several hundred million in interest. P.L. 99-177 mandated that Social Security be refunded for those lost funds.

Question. Can you tell us what you've done to comply with this provision, and where this repayment shows up on the budget?

Answer. When the funds in the Social Security account were redeemed earlier than usual to make benefit payments, the fund lost approximately $9 million, not several hundred million.

As authorized by Section 272 of Gramm-Rudman, Treasury took the actions required to fully restore the trust funds in December, 1985. These actions were:

1. As of December 12, restored $6.267 billion principal amount of 10⅜ obligations maturing 1987 through 1989 that had been prematurely redeemed in September. (The restoration of securities prematurely redeemed in October and November was accomplished as of November 14, as required by the temporary debt limit.)

2. On December 31, we transferred $9.240 million to OASI and $437,000 to DI to compensate for 1985 interest losses. These were almost entirely due to the accelerated November redemptions.

3. On December 31, we transferred $372,286,000 to OASI to compensate it for interest losses caused by premature redemptions during the 1984 debt limit impasse. (DI was not adversely affected in 1984.) This is subject to adjustment in June 1986 if the June formula interest rate is different than the 9⅞% rate used in the initial calculation.

The interest repayments are reflected in the Monthly Treasury Statement for December 1985 on page 15—Treasury, Financial Management Service, Other as part of the $490 million and also on page 19 under Department of Health and Human Services, FOASI included in the semi-annual payment of $1,159 million and under DI included in the semi-annual payment of $179 million.

Question. Are the trust funds now restored to their proper level?

Answer. Yes, the trust funds were all restored to their proper level.

Question. I believe that the American people will not accept boosting defense 3% above the inflation rate, while taking $40 to $60 billion in deficit reduction out of the hides of programs meant to assist the needy of this country. Unless we come up with an alternative agreeable to the Administration and to the Congress to the Gramm Rudman cuts that will occur on October 1, barring a favorble decision tomorrow in the constitutional challenge I and 11 of my colleagues have brought against Gramm Rudman, both domestic and defense programs will be cut to the core.

And unless the Administration is willing to contemplate new revenues of some sort, I do not believe we will be able to come up with any alternative.

As far as I am concerned, if the door is closed on new revenues, and Gramm Rudman is ruled constitutional, which is hard to believe, then the ball game is over. We might as well go home and let the computer take over carrying out Gramm Rudman.

With regard to new revenues, I have grave reservations about an oil import fee, because of its differential impact that would hit hard on the Northeast, and because of the windfall it would provide domestic producers.

I believe it would make much more sense to talk about a Gas Tax, which would have a much more even impact across the country, and would not provide a windfall to domestic producers.

Would you comment on your views as to the relative merits of a gas tax versus an oil import fee?

[Additional material to be submitted to the Committee for the record.]

Question. One of the "high priority programs" in the President's budget is the "enforcement of drug laws." Yet, the budget proposes to cut some 1,500 positions from the Customs Service, a lead agency in the flight against drug smuggling. This personnel reduction is in addition to a $19 million cut in the air program.

How will we more effectively enforce our drug laws with 1,500 fewer positions?

Answer. Customs can effectively enforce our drug laws. In a time of $200 billion deficits, the Federal Government must operate within static or reduced resources. The Customs Service is no exception. In response to these curcumstances, each individual Customs office has become more effective. During the past 5 years, while cuts in Customs inspectors and other enforcement personnel were proposed, Customs has implemented numerous programs to better equip its inspectional and enforcement forces to cope with the growing drug smuggling threat. Private and pleasure vessels and general and corporate aviation, which visit drug source or transit areas, are subject to closer monitoring and more frequent searches. In cooperation with Customs, commercial shipping and airlines have taken steps to make their ships and planes less vulnerable to narcotics concealment. Special emphasis operations have concentrated on outbound currency, on cargo and passenger arrivals from high-risk departure points, and on entry points particularly favored by smugglers.

As a result of enhanced communication and automation initiatives implemented in the past several years, improved communication, more specific intelligence, studies of current seizures, and analyses of patterns formed by persons, goods, mail, and conveyances arriving from foreign locations, have aided inspectors and enforcement personnel to more effectively filter out those individuals and shipments with high smuggling potential from legitimate commerce. Customs continues to search out innovative methods to quickly distinguish smugglers and contraband.

In order to ensure the most effective results with reduced resources, Customs continually monitors and reevaluates current deployments of personnel and related equipment. Customs will continue to reallocate resources from areas of lower threat to those of intensive smuggling activity.

In addition, programs such as toll-free lines for reporting suspicious activity, Customs-sponsored Explorer posts, and public awareness programs have helped build public support. Close cooperation with other Federal enforcement agencies has contributed to the disruption of criminal enterprises. All of these are integral to our drug interdiction efforts and will continue to improve our enforcement.

Question. I can't understand why the Administration has targeted this agency for cuts year after year. Besides drug enforcement, Customs is a significant revenue producing agency—some $13 billion a year.

How do you plan to meet increased projections for revenue collection—some $15 billion—with fewer people? Before you answer, automation cannot make up this kind of personnel shortfall. People in Washington may believe it, but nobody in the field does.

Answer. Increased collections will be realized as a result of an incremental increase in the volume of imports, which in itself will bring in additional duty revenues, and through better utilization of import specialist resources.

Customs has been able to absorb an increase in import entry workload through greater use of selectivity to identify those importations whose complexity profile requires intensive review by import specialists. In this manner, we can target the use of import specialist resources to high risk commodities with a greater likelihood of revenue returns. The remainder of the entry workload is processed with a less intensive review by import specialists and clerical review personnel. Random sampling of these entries, together with post-audit reviews and quality assurance checks after liquidation ensures the integrity of the process.

It is quite correct, as you have stated, that automation alone cannot do the job. However, it is also quite true that automation is a formidable tool, which when applied to Customs entry processes can greatly enhance the efficiency of our work force. Automation will allow us to identify repetitive transactions which while complex present little risk to the revenues. Time saved by these methods can be used to review initial importations and new products and to verify entry data at importers premises.

These processes have allowed us to concentrate on highly sensitive commodities such as textiles, steel, and electronics to a much greater degree than in the past. Our aggressive enforcement efforts have had a salutary effect on collections by instilling a credible deterrent effect on importers which supports a greater incidence of voluntary compliance with tariff and administrative import requirements.

These initiatives, coupled with more automated support for import specialists and simplification of documentary procedures will, when taken together, enable the Customs Service to collect more money with fewer employees.

Chairman WHITTEN. Mr. Boland.

Mr. BOLAND. Mr. Chairman——

Mr. JAMES MILLER. I would like to agree with you, Mr. Conte, always.

Mr. BOLAND. Mr. Chairman, I have been attending these hearings now for many years and every year we ask dozens of questions of witnesses and I am struck by the fact that we oftentimes get answers which are long statements of administrative policy, and by the way, it doesn't make any difference which Administration witnesses are before us, whether Democrat or Republican. So this year, Mr. Chairman, I thought I would take a different approach. I will make the statement and skip the questions.

For the past four or five years, we have been hearing the same story. Each year we expect that the next year's budget deficit will be lower and when the numbers come in we find that the deficits keep growing. In fact, in FY 85 we had the largest deficit in the history of this country—$213.3 billion, and we had that deficit amid relative prosperity.

So what do we do? We pass the Gramm-Rudman Act and I believe that was passed probably out of a sense of frustration because neither the Administration nor the Congress can come to grips with making the necessary spending reductions or raising taxes to pay our bills. There is plenty of blame to go around on both sides. But when this Administration submitted the FY 83 budget it projected that the FY 86 deficit would be $66 billion. Well, it won't be, it will be out of balance by almost $200 billion.

So what that means is that the budget projections have been wrong and don't fly. To blame it on the Congress or Congress' spending habits—is simply not fair.

I wonder if you know how Congress actually affects spending each year in relation to the President's budget request? All of the actions that Congress takes on the budget, every single one of them, entitlement programs and discretionary programs, do not change spending for any fiscal year by more than two percent over the past five years, not over two percent, and guess what—the Congress making a spending adjustment of two percent is not what causes $200 billion deficits. So you can't blame the Congress.

The fact is that there just isn't enough income to pay the bills. You can't cut taxes by $750 billion and raise defense spending by $600 billion and expect to balance the budget. It just won't work, and the former director of OMB, Dave Stockman, was hauled off to the woodshed because he had the audacity to tell us it wouldn't work and you know he was right.

So if we are not going to raise taxes to pay the bills, the Congress felt it had to do something and that something turned out to be the Gramm-Rudman bill—and it is about the least desirable solution that one can come up with, but what about your solution? Not only are your budgets misleading, they are also unfair. I wouldn't mind if everybody shared the pain. I wouldn't mind if some parts of the budget shared more pain than others because you have to arrange priorities among programs rather than just cutting things across the board by the same percentage. But when you are so unfair in the distribution of those cuts, that is wrong.

It happens that the committee that I chair, the HUD Independent Agencies Committee, has taken its share of the cuts necessary to control federal spending. I don't know whether you are aware of what the level of the HUD appropriations bill was in fiscal year 1981. I will tell you what it was. It was about $75 billion and this year it is only $58 billion, and that doesn't take into account the impact of inflation. You may not realize how much of a cut the subsidized housing program has already taken. Subsidized housing was at a $30 billion figure in fiscal year 1981 and last year we provided $9.8 billion. The Administration and the OMB agreed to that number in the 1986 HUD bill.

We met the Senate outlay targets that were our share of last year's budget resolution, but the Administration has not carried out that agreement and has sent up here Draconian cuts in subsidized housing for both FY 86 and '87.

I know what the theory was. You believed we were going to grow out of these deficits. Dave Stockman knew that we couldn't. We are not going to grow out of these deficits and until somebody realizes that, we are going to be in the soup for a very long time because Gramm-Rudman is not the solution to the problem.

Mr. Chairman, that ends my statement and I have no questions.

Mr. James Miller. Mr. Chairman, could I respond?

Chairman Whitten. Yes.

Mr. James Miller. I would like to respond to two points made. With respect to the President's original promise for outlays, according to page 213 of the budget document, the budget of the U.S. that the President just submitted, it turns out precisely that outlays for 1985 were $100 billion more than the President had originally proposed.

Mr. Boland. Well, the fact of the matter is that with respect to the HUD-Independent Agencies bill that when we went to conference with the Senate we had to meet the outlays ceilings of the Senate which we did, and that was one reason why you agreed with Senator Domenici that if we met the outlay figure of the Senate that the bill would be signed and that promise was kept.

But now we are getting the run around. You are coming up with deferrals and rescissions that reneges on a promise that you agreed to last November.

Mr. James Miller. I guess we are talking about three different things. I am talking about here your suggestion that the President's budget did not deviate from what Congress had proposed, and I am saying that the President's original budget did propose a level of spending for 1985 that was precisely $100 million less than was actually spent.

The second thing is on the HUD budget. At the President's direction, we were very strong on holding the 302(b) allocations within the Congressional budget compromise but never suggested that all of the policies were set in concrete or that we would not come back at some point and ask for a deferral.

We have a number of comparisons of some of the BA. Note that there is not BA for housing in 1987. Keep in mind there is $249 billion of BA, budget authority for housing already in the pipeline that is going to spend out for the next 20 years and even if there were no BA for new housing some 500,000 more households would receive assistance in 1991 than today.

What we are doing is proposing to convert some of these means for new housing construction, which is very expensive, to housing vouchers, with which we can get a family into a home for a third of the cost of building new units. The 1985 to 1986 66 percent reduction, keep in mind, is somewhat misleading because there was a one-time purchase by the government of tax exempt public housing notes after the tax change.

Mr. **Boland**. One of the problems we have of course in housing is the production of incremental housing where you add to the housing stock. You don't add to the housing stock with a voucher system at all. We have 5,000 units in the fiscal year 1986 bill for public housing.

That has been all but eliminated in fiscal year 1986. You are providing for 800 some units and that is all. We have a million four hundred thousand public housing units in the U.S. that shelter better than 4 million people.

It is a program that has worked and the very poor can realize safe sanitary and decent housing. That is the area that the Administration makes a mistake in recommending that kind of a reduction.

Mr. **James Miller**. Of course no one wants to see people go homeless, but I disagree with your contention that vouchers have no effect on housing stock. They can increase housing stock. For every dollar put in a voucher we would increase the housing stock three times what it would be to put it into public housing.

Mr. **Boland**. Practically all the voucher system which deals with existing housing—where the recipient finds go own unit, isn't that true? It doesn't add to the total number of housing units available.

Mr. **James Miller**. I don't mean to seem at all disrespectful but if I purchase a loaf of bread at the local market one could say that has no effect on the total flow of bread to the market but it does because there are incentives. If you have a voucher and use that if the amount of housing is insufficient then more will be built.

Mr. **Boland**. Of course one of the big problems, as you know, is the fact that the vacancy rate is very low and it is almost impossible to make a voucher system work successfully when you run into that kind of a climate. Also, when you talk about the market adding new units—those units are not added for low-income families.

Mr. Chairman, thank you very much.

Thank you, Mr. Director.

Chairman **Whitten**. Mr. Natcher.

Mr. **Natcher**. Thank you.

We are delighted to have all three of you before the committee at this time and Mr. Miller, especially you, in this your first appearance before our committee.

Our subcommittee's relationship with your predecessor down through the years I think was excellent.

I am Chairman of the subcommittee that makes the recommendations for the Departments of Labor, Health and Human Services and Education and related agencies.

Mr. Conte is not only the Ranking Minority Member on this full committee, but he is the Ranking Minority Member on the subcommittee. On the subcommittee we have 13 members, including our Full Committee Chairman, Mr. Whitten. We work together, we like each other and bring out a good bill each year. We spend 14 to 16 weeks on our hearings.

President Reagan has signed our bill in the last three years. For 1986 seven of our appropriations bills are included in the Continuing Resolution. The President has signed six out of the 13. As I said, in the last three years the President has signed our bill and we appreciate it.

We worked with Mr. Stockman on a number of occasions to bring this bill in line so that it would be signed. Last year, when we presented the conference report on the 1986 bill in the House, we reduced it 38 million on the Floor, to make it acceptable to the President.

Mr. Chairman, you know from time to time you hear the Congress criticized for spending all this money. If you will check the records in your offices you gentlemen will find that there have only been four years out of the past 43 years when total appropriations approved by Congress exceeded the President's request.

Mr. Miller, I think that is a pretty good record. In this budget that we have before us today of $994 billion I understand that we have an increase in defense of 13 percent. We have an increase in foreign aid of 16 percent. Those figures are right, aren't they, Mr. Miller?

Mr. **James Miller**. Are you talking about outlays——

Mr. **Natcher**. I am talking about the budget authority allocated for foreign aid and for defense. What is the increase as far as defense is concerned?

Mr. **James Miller**. In budget authority it is three percent in real terms above 1985, three percent above in real terms above the Congressional Budget Resolution of last August.

Mr. **Natcher**. What will that total as far as amounts are concerned? What is wrong with 13 percent? Is that figure wrong?

Mr. **James Miller**. I believe it is.

Mr. **Natcher**. What is the figure?

Mr. **James Miller**. It is three percent over the Congressional Budget Resolution, actually a little less than three percent in nominal terms plus the assumed rate of inflation in the CBR and it is three percent above in real terms above the 1985 figure.

In the continuing resolution Congress proposed 295.5, which, compared to the 302.5, is at least one percent below. Then of course there was a 6.3—excuse me—a $13.3 billion sequester budget authority for defense, and so defense is down some from the 295.

We look at it more like six percent decrease combined with a six percent restoration to the resolution level so the increase would be more like eight percent than 13 percent in budget authority.

Mr. NATCHER. As far as increase in the cost of living, as far as the overall increase in defense, and Mr. Addabbo, who sits here to my left has these figures better than I do, as far as his subcommittee you will find that the figure is going to be closer to 13 percent, Mr. Miller.

As far as foreign aid is concerned what about a 16 percent increase, is that right or wrong?

Mr. JAMES MILLER. Let me give you what the figures are.

Mr. NATCHER. Yes.

Mr. JAMES MILLER. For defense, the outlays contained in the pre-Gramm-Rudman for defense for fiscal year 1987 was—in budget authority, was 289.4 and 311.6, and in outlays it was 263.6 to 274.3, and after Gramm-Rudman sequester the number is 278.4 raised to 311.6 and in outlays it is 258.4 raised to 274.3.

I believe that is not quite 13 percent, but let me check—

Mr. NATCHER. It would be pretty close.

Mr. JAMES MILLER. Let me check those figures.

Mr. NATCHER. Go right ahead.

Mr. Chairman, while Mr. Miller is checking the figures, I don't know anyone in this country that is in favor of placing the security of our country in danger as far as defense is concerned.

I don't know anyone that fills that category, Mr. Chairman. As far as foreign aid is concerned a certain amount of it, I think, is necessary but when you come in and say 16 percent and then you take a $16 billion reduction in a bill that proposes money for health and education I think, Mr. Chairman, it is a mistake.

What is the figure, Mr. Miller?

Mr. JAMES MILLER. It is nine percent for outlays and I was calculating it for budget authority. The numbers on it are much smaller than my fingers. I hit twice.

Mr. NATCHER. Mr. Miller, you can put that in the record. That question will be asked again—Mr. Miller, as far as the bill that proposes the money for Labor, Health and Human Services and Education, did you mean to cut biomedical research by $414 million? I want to read a number of these to you.

Will you give us an answer?

Mr. JAMES MILLER. I have nine percent and 12 percent just in terms of the——

Mr. NATCHER. Nine and 12 percent. Nine for what, Mr. Miller?

Mr. JAMES MILLER. Nine for outlays.

Mr. NATCHER. Biomedical Research, $414 million, cancer research by $66 million. Job training programs by $577 million. Cut in Education for the handicapped by $107 million.

Did you really mean, Mr. Miller, to cut the student assistance by over $2 billion, cut vocational and adult education by $441 billion? Cut rehabilitation of the disabled by $136 million, impact aid category B by $130 million, higher education institutional aid by $201 million, library assistance $107.5 million?

These are the figures that concern me. The ones pertaining to the Labor, HHS, and Education Appropriations bill. If there is an appropriation bill of the 13 bills presented before our committees each year that could be called the people's bill, it is this one.

Education and health is where the money should be. Mr. Miller, as you know, we had in our conference matters pertaining to social security, the staffing level and office closings. During the conference we refused to accept Senate bill language. We thought we were right, Mr. Miller.

If I was President of the U.S. and you sent me a bill and I wanted to disagree with your numbers and I found language there concerning staffing levels and office closings and social security, that would give me a good opportunity to veto the bill.

What are your plans both in 1986 and 1987 regarding staffing levels and office closings in the social security system, Mr. Miller? Can you tell us?

Mr. JAMES MILLER. Well, we do not anticipate, as I recollect, closing any social security offices. We have some improvements that we hope to be able to obtain. It is subject to check. I just don't recollect.

Mr. NATCHER. You are asking I believe $351.7 million for the job corps in 1987; this is a reduction of $288.3 million from the original 1986 appropriation. The number of disadvantaged youths in the program would drop to about 22,000.

This is a 45 percent reduction. Is this a wise reduction as far as the job corps is concerned? What do you say about that?

Mr. JAMES MILLER. Yes, it is. As you may remember, sir, the Administration last year suggested eliminating the job corps. I made a review of the job corps and I went into some of the analysis that had become available since then and we concluded that there was some very expensive portions of the job corps.

Some of the training centers were very expensive, and were not cost effective, and so our suggestion was to cut it back, in fact, cut it back to the point that the size it was at the first part of President Carter's administration.

Could I just make an amendment. The percentages I was giving you, Mr. Natcher, were nominal, not real increases for defense. Also I recalculated just for the record—it appears that I was in error when I told you earlier it was nine ercent, it was 6.2 percent on the basis of outlays and 11.9 percent on the basis of budget authority and that is for the 051 defense, Defense Department portion.

That does not include the portion of the Department of Energy that is sometimes attached, which is the 050 line for defense. It appears that at least on the basis of BA, it is about 12 percent nominally for budget authority for defense 050 function as well.

Mr. NATCHER. Mr. Miller, as you know, the budget request for the Summer Youth Employment Program is only $428 million, a reduction of $236.5 million from the 1986 appropriation. About 230,000 summer jobs for disadvantaged young people would be eliminated.

Have you thought about the impact that the loss of 230 thousand summer jobs would have on the disadvantaged youth of this country, Mr. Miller?

What would your answer be to that?

Mr. JAMES MILLER. My answer is two. There are a number of block grants that communities can use for job training for disadvantaged youth if they want.

The more important thing, Mr. Natcher, is that our intent in doing something about the deficit is to extend the remarkable expansion in the economy that we have experienced over the past three years, three-plus years, as the Secretary indicated.

We are now in the 39th month of an expansion. This can do more for disadvantaged youth than any government program conceived on the drawing boards of Congress or in the administration.

Mr. **Natcher**. Thank you, Mr. Miller.

As I said in the beginning, Mr. Miller, we on our subcommittee intend to work with you and your associates. We have done it down through the years, and it has helped us, and we appreciate it.

These matters all concern me, but we will have a chance to talk to you before the year is over about more of them.

Chairman **Whitten**. Mr. Myers.

Mr. **Myers**. Gentlemen, this may be the first meeting we have had this year, but with the statutory requirements placed on the Executive and Congress, I feel confident we will see each other rather frequently this year, as we try to resolve the problems confronting the country, and particularly those of us who have to decide where the cuts are going to be made.

I was somewhat concerned with the colloquy a moment ago, Secretary Baker, that you had with Mr. Conte about the tax. The President has been quite adamant as I have read the President, that he would not vote for any tax changes, he calls them reform, that will raise revenue.

TAXES

He told me that when he asked me to vote for the tax package before the House which I would not have supported. Why is it so important as we look for tax reform, which is badly needed, why is it so important that any tax bill be revenue neutral?

I realize this is not the responsibility to write taxes on this committee, but we are all Members of the Congress and have responsibilities to constituents. What is so important that the President is so emphatic that it must be revenue neutral?

Secretary **Baker**. The President feels that the biggest mistake we could make would be to start raising taxes. That has been the centerpiece of the national debate now for probably the last two years.

It was the overriding issue in a national referendum election that we have just experienced shortly over a year ago. The American people were very loud and clear in their answer with respect to whether or not they wanted a tax increase.

They don't want one. The President doesn't want one, and while he thinks it is important that we reform the tax code, he doesn't want to see that exercise used as an excuse for a tax increase in disguise, and he doesn't want tax reform to turn into an exercise in increasing taxes.

Mr. **Myers**. I think he is quite right. At the same time, I don't find a hue and cry from the electorate asking for tax reform. They don't trust us, think we have the capacity or talent or courage to write meaningful tax reform.

So I think we will probably forget tax reform. I yield to Mr. Conte for a comment.

TAX LOOPHOLES

Mr. **Conte**. Mr. Baker said he doesn't want to increase taxes. We want to plug up loopholes. We don't want to raise taxes. Just plug up some loopholes.

Secretary **Baker**. Whether we call it revenue enhancing or loophole plugging, the President is against it, and he is not going to participate in that exercise.

Mr. **Myers**. Reclaiming my time.

I don't disagree. Putting an extra burden on the consumer, I think that is what the President is concerned about. He says, "We have a delicately tuned economy, and it is recovering, and I don't want to do anything that might destroy that recovery, as gradual as it is," and I think we agree.

But if those out there not paying taxes, if we make them pay their fair share and those who aren't paying their fair share can pay more, and we can raise more revenue, I see no objection to it.

Suppose we have a delicately tuned economy and we don't want to pass it on to the consumer? Mr. Conte spoke about the oil import tax, and you said the President has left that open?

Secretary **Baker**. He has left open the possibility of considering that, but only in the context of a revenue neutral tax reform package that otherwise meets his requirements.

Mr. **Myers**. I believe the President said on this, if it is in the same tax category and not raise more money, but then still, if it is an export or an import tax, you are passing it on to the consumer.

It would defeat what I think the President is telling us.

Secretary **Baker**. The President is saying, "I don't want to see an extra dollar in taxes imposed upon the economy in the aggregate."

Some will argue that the tax reform package that we proposed in Treasury 2 is an increase in taxes, because it increases taxes on business and lowers taxes on individuals.

When the President talks about a tax increase, he is talking about taxes in the aggregate imposed upon the U.S. economy.

Mr. **Myers**. A great many people today say, "tax business or corporations," and some do not pay their fair share. However, I don't know of any corporation who pays taxes.

They pass it on to us as consumers, who have to purchase the goods they produce, and there is an add-on fee.

Secretary **Baker**. Ideally, it would be nice if we could eliminate the corporate income tax, I agree, but that will never happen.

Mr. **Myers**. That will never happen, but we ought to be fair.

Secretary **Baker**. You are right, it is nothing but a passthrough to the ultimate taxpayer.

Mr. **Myers**. Let's get on with this committee's responsibility. This year, I think we are going to be seeing a lot of each other because we are going to have to give and take a lot. There are going to be differences from the President's request.

When the Congressional budget comes up, we on Appropriations will come up with a different figure from the authorizing committee, and then we have the budget reconciliation, we will have the snapshot in September.

We are going to have changes all year long. What happens, Mr. Miller, if in September we come along and you suggest deferral of some item that we have put in and it is deferred until next year.

DEFERRALS

Can you change the intent of Congress on that deferral, and spend it for a different category than Congress intended in this year's appropriation, can the administration do it?

Mr. **James Miller**. The administration can send up a deferral.

Mr. **Myers**. Can they change the intent of Congress what the money was originally proposed for?

Mr. **James Miller**. The President can send up a deferral and that lasts for only a period of time. Under law, I understand it can be converted into a recission on which Congress has to act or else the President spends the money.

Mr. **Myers**. The first quarter of the next fiscal year, and if not, Congress has to be notified, but could the intent be changed through the deferral process from what Congress intended the money to be spent for?

Mr. **James Miller**. No, unless there were recissions, in which case Congress would have to approve the recission.

Mr. **Myers**. It would have to be reappropriated?

Mr. **James Miller**. That is correct.

Mr. **Myers**. I have a closing comment here again. With Mr. Conte, you talked about the General Services Administration and the assessment that they make to the various agencies of the Federal Government for rental, for maintenance, for services and you said it was out of pocket and transfers.

You are right, to a point. However, you take away from the subcommittees of this Appropriations Committee the opportunity to know just how that money is spent by the various agencies.

It is insulated. My experience has been as a business person you need to have as close an oversight there, and if GSA has so many dollars to spend, whom do they account to? How do we know that they are not wasting money?

If we gave it directly to the agency coming before the subcommittee for the substantive purposes, we could have an oversight to see how the money is spent, but GSA is insulated somewhat. You don't get that close scrutiny, because the person that spends doesn't have to come to Congress to ask for it.

Mr. **James Miller**. Your point is well taken.

[The following questions from Mr. Myers were submitted for the record. Responses were provided by the Department of the Treasury.]

Question. In your prepared statement you said that a weakening Japanese growth rate would be unfortunate. Why?

Answer. Strong Japanese growth is highly desirable both for the Japanese themselves and for creating a more sustainable pattern of world growth and trade balances. With the yen at a seven year high against the dollar and, even in inflation adjusted trade-weighted terms, at its highest level in several years, a significant decline in Japanese export competitiveness is taking place. While the weakening of Japanese exports and the strengthening of Japanese imports comes only with a lag, the effects are already visible in a much smaller contribution of the foreign trade sector to Japanese growth. If this effect is not balanced by stronger domestic sources of growth, the result will be less growth in income for the Japanese and reduced imports from other countries as the slow growth in Japan outweighs the exchange rate effect on imports. Such a development would be harmful to prospects for stronger and more sustainable world growth and could lead to a resurgence of protectionist pressures.

[The following questions from Mr. Myers were submitted for the record. Responses were provided by the Council of Economic Advisers.]

Question. Mr. Sprinkel, is there a relationship between the trade deficit and the budget deficit? Will interest rates be directly lowered by deficit reduction or is that up to the Fed? Would increased equity investment improve the trade balance?

Answer. The relationship between the trade deficit or the current account deficit and the budget deficit is discussed in Chapter 1 of the Annual Report of the Council of Economic Advisers, specifically, pages 50 to 54. Holding domestic investment and domestic private savings constant, a lower budget deficit implies a smaller excess of national spending over national income and hence a smaller trade and current account deficit. In this sense, reducing the budget deficit may be said to contribute to reducing the trade deficit.

The link between budget deficits and interest rates is more tenuous. Empirical studies have found it difficult to isolate any significant effect of budget deficits on interest rates. Nevertheless, I believe that lower interest rates may result from determined action to reduce the budget deficit through limiting Federal spending. Such action would allay concerns of higher future tax rates to reduce the deficit or of renewed inflation resulting from future efforts to inflate away the real value of the government debt.

Lower interest rates would presumably provide additional stimulus to domestic investment, including investment in housing. By itself, an increase in domestic investment (holding domestic savings constant) would not improve the trade balance. Rather it would tend to offset the effect of deficit reduction on the trade balance. In the longer term, however, higher investment means greater domestic production. Holding the path of domestic spending constant, greater domestic production implies a longer term improvement in the trade balance.

Mr. MYERS. We will be seeing a lot of each other, I am sure. There is going to have to be a lot of give and take. It bothers me, because Congress has always had different choices than the Administration, and I think we should discuss things with an attitude of cooperation.

Mr. JAMES MILLER. I look forward to that.

Chairman WHITTEN. Mr. Addabbo?

Mr. ADDABBO. Mr. Secretary and Mr. Director, as we look over the budget, the only thing I can think of is here we go again, business as usual, increase defense and cut all the human services programs.

As Mr. Natcher rightfully pointed out and you disagreed, there is definitely a 12-percent increase in DOD programs for fiscal year 1987, over the fiscal year 1986 base amount, which includes the effects of the Gramm-Rudman legislation reduction. That would provide the Defense Department with over $311 billion, while most non-defense programs are eliminated, reduced or receive no increases.

How will the President propose to finance this huge increase in defense programs? We look at the budget, and it says business as usual. The President spoke about helping the poor in his State of the Union address, and yet he proposes to eliminate urban development grants, the Economic Development Administration, the small business credit program, and we know small business is the backbone of our economy.

The President proposes to eliminate the Legal Services Corporation which gives the poor representations in the courts, he proposes to cut medicare, child nutrition, student aid, medicaid, food stamps, Aid to Families with Dependent Children, the veterans' medical care, while increasing the power to kill through higher defense requests but, failing to take care of those who made this country free.

In the State of the Union, the President said defense is not just another budget expense. Keeping America strong is totally the responsibility of the Federal Government.

He said it is the government's prime responsibility. Maybe he forgot what the preamble to the Constitution said. It says we the people of the United States should provide for the common defense, comma, not and/or, it says comma, promote the general welfare, the Constitution puts defense and non-defense on an equal basis, not an unfair basis, which this budget does.

As Mr. Natcher pointed out, you are cutting student financial aid, which will mean again, that, most of the middle class will be financially strapped, over a million students will be affected. As Mr. Boland pointed out, you intend to terminate future commitments to section 202 housing for the elderly and handicapped.

In my City of New York, vacancies are hard to come by for most people, and when available are likely to be unaffordable. Over the years, the Congress has been for a strong defense, but we also want our money's worth.

For the past five years, DOD has received $1.2 trillion in budget authority, a 61-percent increase over fiscal year 1981, or an average annual increase of 12.2 percent.

So, therefore, the Congress cannot be accused of short-changing the defense programs. Can you imagine the Defense Department will have built up an unexpended balance of $299.7 billion as of end of fiscal year 1987.

This exceeds the total amount of our deficit projected for FY 1987. DOD has $60.3 billion which is estimated to be unobligated. We also know that some of the obligated funds will be de-obligated and used for other programs.

I guess what is extremely frustrating and discouraging is that Congress is asked to vote for the large defense increases and reduce or eliminate many of the human needs programs but we also read about the Defense Department purchasing a $37 screw, a $436 hammer, $3,100 plastic stool caps, a $9,600 wrench, a $600 toilet seat and an $8,000 coffee maker.

Just recently, and we have opposed it over the years, the DIVAD air defense system had to be canceled after spending hundreds of millions of dollars because it moved too fast from R&D into production. I know the President and the Department of Defense have their problems, but the Congress has been more than generous in providing for the President's defense needs.

We need to maintain a more balanced approach between nondefense and defense spending.

Mr. Miller, did the President see the budget before preparation of the State of the Union message?

Mr. **James Miller**. Of course, he did.

Mr. **Addabbo**. If so, then how come his State of the Union message does not coincide with the fiscal year 1987 budget as just submitted?

He speaks of providing jobs. He says not to control, not to command, not to contain us, but to help in times of need, above all to create a ladder of opportunity to full employment, so all Americans can climb toward economic power and justice on their own.

And yet, when we look at the budget we find a cut in the jobs programs. He speaks to the American people again, and says, I have said before the most powerful force we can enlist against the Federal deficit is an ever-expanding American economy unfettered and free. But yet we look at the budget and the SBA loan programs are practically eliminated and small business is the backbone of our economy and we see a cut there.

He goes on talking about we must never again cripple our farmers and other exporters. Farmers in particular have suffered from past unwise government policies.

He says further they must not be abandoned and strapped with problems they did not create and cannot control. Then we look at the budget and find we are eliminating the disaster program. Do you know what insurance costs?

I live in a residential area, a low flood area, I have to pay $1,000 a year for Flood insurance. The poor farmer will be driven into bankruptcy.

We worry about the farmers and yet cut out disaster loans so that makes me wonder, Mr. Miller, whether or not the President saw and was explained the budget which he sent up a day after his message to the country. We speak of the 12 percent defense increase and you say no it is a three percent increase.

I guess you didn't read the budget. On page 5-5 of the Budget of the United States, the fiscal year 1986 estimate is $286.1 billion. The FY 1987 budget estimate is $320.3 million, that is a 12 percent increase by any man's figures, unless you didn't see it.

Mr. **James Miller**. Could I respond?

The number reported to me was 13 percent and I took issue with that——

Mr. **Addabbo**. It was wrong by one percent.

Do you agree that it is 12 percent?

Mr. **James Miller**. I think the record will show that I said that, in terms of budget authority, it was 11.9 percent in nominal terms, and when I talked about a three percent increase I talked about a three percent real increase over the level that was in the Congressional Budget Resolution.

Mr. **Addabbo**. May I repeat in your budget, the FY 1986 estimate, is $286.1 billion, and the FY 1987 budget is $320 billion, isn't that a 12 percent increase?

Mr. **James Miller**. I think the figures speak for themselves and I was explaining the difference between nominal and real increases.

I would like to take issue——

Mr. **Addabbo**. Isn't that really money?

Or is that nominal money?

That is a lot of dollars you are talking about.

Mr. **James Miller**. I think our estimates speak for themselves. I would take umbrage with your characterization of the President's State of the Union message not coinciding with the budget submission.

First of all the President did review the budget in some detail before the State of the Union and before he sent it up here. His discussion in the State of the Union about jobs, of course, he is very concerned about jobs and he is rightfully proud that this economy under his leadership has expanded enormously and the number of new jobs created because of an expanding economy dwarfs by major scale any increase in jobs that come from government programs at job training.

The Small Business Administration has a loan program directed toward the one percent of small businesses, an expanding economy does more for small business than any SBA loan program.

Mr. **Addabbo**. Do you know how many small businesses have gone bankrupt because they could not get proper aid from the Small Business Administration last year? But you made deep cuts in their programs this year?

Mr. **James Miller**. The number of small enterprises is at an all time high. The farm problem, the President signed a farm bill that was more generous than any other President has.

The disaster program that you were talking about, there has developed a private market for this kind of insurance and also for crop insurance, and the budget includes the Federal Government's getting out of what now is a viable competitive marketplace.

Thank you.

Mr. **Addabbo**. I have no further questions at this time, Mr. Chairman.

[The following questions from Mr. Addabbo were submitted for the record. Responses were provided by the Office of Management and Budget.]

Last year, CBO reported very large amounts of savings on Air Force contracts that employ economic price adjustment clauses. CBO estimates that $177,100,000 in just the C-5B production program alone is excess to requirements. The Appropriations Conference Committee for fiscal year 1986 required OMB to formally propose for rescission all C-5B EPA savings as contract adjustments are made (Report 99-450, page 221).

Question. Does OMB intend to comply with the instructions of the Conference Committee?

[Additional material to be submitted to the Committee for the record.]

Question. What mechanism has OMB established to ensure that the Air Force does use these funds for other purposes, as it has done in the past?

[Additional material to be submitted to the Committee for the record.]

Question. What is the current timetable for EPA adjustments under the C-5B contract?

[Additional material to be submitted to the Committee for the record.

Question. The Committee wonders why OMB failed to notice the savings found by CBO in fiscal year 1986. Has OMB made a more thorough examination of FY 87 Air Force programs that use EPA clauses or should we expect "business as usual"?

[Additional material to be submitted to the Committee for the record.

The Committee has long been concerned about the Administration's priorities for funding new DOD acquisitions instead of improving the readiness of the existing forces. We understand that OMB reduced over $1 billion from the Air Force's fiscal year 1987 replenishment spare parts budget.

Question. How much did OMB remove from the Air Force FY 87 replenishment spare parts budget request?

Question. What was the rationale?

Question. What impact does OMB perceive this action to have on Air Force readiness?

Question. Is the OMB FY 87 funding reduction redundant with the congressional $800 million reduction to FY 86 Air Force replenishment spares, which was based on faulty requirements?

Question. The Air Force claims that a large portion of its "requirement" remains unfunded. Does OMB agree, and if so, why is this acceptable to the President?

Question. Does OMB consider the Air Force FY 87 replenishment spares budget to be fully funded?

Question. Does OMB expect the Air Force to be able to eliminate its large prior year spare parts unobligated balances as a result of this action?

Question. What role did the OSD initiative to reduce the use of undefinitized/unpriced contracts, particularly in the Air Force, play in reducing the Air Force FY 87 replenishment spares budget request?

[Additional material for questions 1-8 above to be submitted to the Committee for the record.]

Chairman WHITTEN. Could I interrupt?

Since you are talking about agriculture, it is true that you get more out of the Treasury. It is because we don't use the Commodity Credit Corporation to provide for payment by the purchaser rather than by appropriations from the Treasury.

Industry and labor which have increased their take of the consumer dollar since World War II from 49 percent to 73 percent while the farmer's share has declined from 51 percent to 27 percent. You don't let the farmer use the CCC to see that they are paid a fair price, instead you make him have to look to appropriations from the Treasury and there he has to compete with everyone else.

Mr. Obey.

Mr. OBEY. Thank you, Mr. Chairman.

Mr. Chairman, I would like to make some objections about the exchange that took place between Mr. Natcher and Mr. Miller because Mr. Natcher was dead right.

One of the two responsibilities I have around here, Mr. Miller, is as Chairman of the Foreign Operations Subcommittee.

I recognize our obligation to meet our national agreements and to meet our economic and military responsibilities around the world not only in terms of the military budget but in terms of our foreign assistance budget. Nevertheless, I have to tell you and I don't mean this disrespectfully, because the secretary and you are both highly qualified public officials, but whoever put this budget together for foreign aid has to be out of their cotton picking minds; and let me tell you why.

As Mr. Natcher indicated this budget calls for sharp reductions in basic health research. I don't think the American public is looking to reduce cancer research. I don't think they are looking to reduce research on AIDS.

I don't think they are looking to reduce——

Mr. JAMES MILLER. We don't.

Mr. OBEY. You do by $31 million from the Gramm-Rudman levels. But, let me compare what you are doing with foreign aid.

If you compare the post Gramm-Rudman sequestering numbers, which are the numbers we are going to have to deal with and live with this year on foreign aid, and your budget, forgetting the EX-IM bank which isn't foreign aid because it represents assistance to our exports, your foreign aid bill this year is $2.2 billion above last year's budgets effective operating levels after Gramm-Rudman passed. That is a 16.5 percent increase.

You budget a 33 percent increase in the give-away military aid portion of the budget. Your budget is a 16 percent increase above post-sequestration Gramm-Rudman levels for all the military lending programs. If you think there is a chance of a snowball in hell of my committee approving that, you are crazy; it isn't going to happen.

It will happen over my dead body. Let me tell you what is going to happen with foreign aid which is an obligation I recognize the President feels strongly about.

I do too.

Most of the time you will find me pushing hard to see we meet those obligations and most of the time I can't find a majority of votes on the President's side of the aisle. If you continue to pursue this gutting of priorities that build our future in terms of job training, in terms of investment, in the kind of human beings we need to be competitive in this world, I will tell you what is going to happen to foreign aid.

The best you are going to get out of my committee is Gramm-Rudman numbers for foreign aid. That is going to mean that you are going to get a 10.7 billion dollar budget number at best.

That isn't what you will get if we could do what we did last year and bring to the Floor foreign aid with a continuing resolution.

This year we can't do that because Gramm-Rudman requires us to bring all our appropriations bills to the Floor by July. I will tell you what is going to happen on foreign aid.

I can't pass one, I can't pass a foreign aid bill standing alone because there is no way on God's green earth that you are going to get more than 20 percent of the members of Congress, at least in the House, to vote for a foreign aid bill which increases anything by one penny when you are savaging what is happening in our own industries.

If you care about being able to manage a Third World debt situation, if you care about meeting our economic assistance responsibilities around the world, if you care about meeting our military assistance responsibilites around the world, then you better find a different mix, because this mix isn't going to get a majority support on the President's side of the aisle, let alone on our side of the aisle.

I find it outrageous that we are expected to support a 33 percent increase in grant military assistance when we are being asked to take health research and cut the blazes out of it, when we are asked to add additional expenses to people's bank accounts if they are trying to scrape up enough money to buy a house under FHA even if they are making less than $40,000 a year.

The second objection I have and I took the subject up with Mr. Sprinkel earlier today, but I would like to do it again with you, Secretary Baker is that you say that the economy is going to grow four percent this year and because you say it is going to grow four percent this year that means that we only have to cut $38 billion.

The administration on average has misguessed, and I don't criticize that because it is impossible to do, you can't guess what the economy is going to grow by but the administration average degree of miss has been 1.7 percent over the last four years. If we are off by the same amount on economic growth from your projection to what actually winds up being the economic performance, here is what is going to happen on the budget.

The President told the country he had a $144 billion deficit. Chairman Gray of the Budget Committee tells me that the budget underestimates defense outlays by $15 billion below what will actually be experienced. That, if he is correct, brings the deficit to $159 billion, not $144.

It means that the amount the Congress has to cut is $53 billion, not $38 billion. And then if you are off by only one percent in your economic estimates of growth, let's say the economy grows at three percent rather than four, which is still 7/10 of one percent better than has been the historical average which the administration has had in meeting its estimates, we would have to add another $20 billion by way of reductions. That could mean that we would have to cut as much as $73 billion out of the budget this year, and what bothers me under these circumstances is what I hear. I continue to hear the rhetoric from Mr. Sprinkel, and I am going to hear it from the Secretary, I know, because he has the responsibility to say it—what you are going to tell us is no new revenues, no new revenues.

In terms of spending, this committee's skirts are clean. If you take a look at what the President asked in appropriations in 1986, 1985, 1984, 1983, 1982, you will find that this committee met the President's targets within two hundredths of one percent over those five years.

I am talking about the budget running from this committee to the appropriations committee. We met the President's overall spending targets right on the button.

But what is going to happen, I am afraid, is that—let me back up. The problem we face around here, and I said this earlier, the problem, Mr. Secretary, is that in this town, too many people believe their own baloney, and on our side of the aisle, our baloney has been what we have said about entitlements. I will grant you that.

I think what your baloney is in what the President says on revenue, and if you want to avoid the kind of chaos that will really screw up this economy, you have to put an end to this nonsense about not looking at entitlements, including the big one that everybody is afraid to touch. And we also have to hear from the administration, of course we are going to look at revenues, because you can't put it together any other way.

I hope the Budget Committee puts the budget on the floor. I hope we have a chance to vote for it up or down without amendment so we can see how many people on both sides of the aisle support that budget.

And then what I think is going to happen to it—what I ask you, sir, is to help to cut the baloney, to get this compromise that people talk about putting together now rather than in October when we are going to be rushing around and trying to do it so quickly we will probably screw it up.

End of speech.

ECONOMIC GROWTH

Secretary **Baker**. Mr. Chairman, may I respond to a portion of what the Congressman said.

I don't deny Congressman Obey that the estimates have probably been off on average by close to 2 percent over the four years. I know in growth we missed on the low side in 1983 and again in 1984, but the fact of the matter is we missed on the high side in 1982 and 1985.

So, while we have been off a little, we have been wrong in a good way as much as we have been wrong in a bad way, and you are absolutely right, nobody can predict with absolute certainty exactly what kind of growth we are going to see.

But from all indications, as far as the recent economic indicators are concerned, we have every reason to believe that the 4 percent figure which we arrived at some weeks ago looks very, very good right now, and I guess the only point I want to make is that while we may have been off 1.7 percent, sometimes we have undershot what the actual growth figures have been.

Mr. **Obey**. Mr. Secretary, could I just ask one question in light of that response with the Chair's indulgence.

Let us assume, however, that nobody is perfect, and so you are off to some degree. It wouldn't be reasonable if you wouldn't be.

Assume Congress passes the President's budget exactly as you sent it to us. We meet the President's numbers exactly on domestic cuts, and we give him the defense budget he wants. We do it exactly.

So, we have cut the $38 billion exactly the way he wants it. Then we come to estimation time under Gramm-Rudman. They say, sorry boys and girls, but the growth is going to be 3 percent, not 4 percent. That means you have got to cut another $20 billion out of the deficit.

Let's assume at that point that the President says, I am sorry, no revenues, and I won't take anything out of defense, as he has been saying.

Let's assume that since we have already taken at that point a huge amount out of domestic spending, that the Congress says, sorry, no more out of programs for folks back home.

At that point, my question to you, sir, is this. What is more important at that point, that we meet deficit target, which would require further deficit reduction of $20 billion at that point, or that the President keep to his position on no revenues?

Secretary BAKER. Well, that is a hypothetical question I can't answer today, because in the first place, I don't think we are going to get there as a consequence of being low on our growth estimate.

In any event, I couldn't answer it because it is hypothetical. Under the law, obviously, sequestration would occur, and would take it 50 percent out of defense and 50 percent out of domestic just as the Congress and the President agreed last year.

Mr. OBEY. You think that will be preferable?

Secretary BAKER. I am not expressing a view on that, because I don't want to get into the posture of answering a hypothetical question like that. I don't think we are going to get there.

Mr. JAMES MILLER. Could I indicate something? Our estimate of the effects of a one percent reduction in the growth rate as shown on page 229 of the budget is that it would cost $6.2 billion in receipts.

If you also assume that that lower growth rate was attendant with higher unemployement, it might add another $1.1 billion. So, we are looking at like a $6 to $7 billion hit, I think, on the deficit if the rate of growth were one percent lower than our assumed four percent. This would be for Fiscal Year 1987.

Also, I am aware that Chairman Gray has indicated that, in his judgment, we have underestimated outlays for defense in 1987 by $15 billion. I have not had the privelege of reviewing that analysis. I would point out, however, that in the past several years that OMB was chastised for having overestimated outlays.

It is somewhat difficult to estimate defense outlays precisely because so much of the budget authority is paid over a long period of time.

Mr. OBEY. You put your chart in the record, and I will put mine in the record, and at the end of the year we will see who is closer.

Chairman WHITTEN. Mr. Miller.

Mr. CLARENCE MILLER. Gentlemen, much of our economic growth is in the service sectors of the economy and in the high-tech fields, but industrial and manufacturing industries are still facing many serious difficulties. There are those who say that the second industrial revolution means that our economy will be based increasingly on service and high-tech industries and that the smokestack industries in our nation will inevitably decline. While I understand there is a shift in our economy with great emphasis on services, I do not think that America can continue to be strong unless we have a sound manufacturing and industrial base.

ECONOMIC GROWTH—MANUFACTURING/INDUSTRY

I would be interested in your views on that subject.

Secretary **BAKER**. Well, Mr. Miller, I quite agree with that. I think it is important that America continue to maintain a sound industrial and manufacturing sector of our economy. I think, as I indicated in my initial remarks to the chairman, we have got to continue to face up to the difficult problem presented by our trade deficit. And while it hits our agricultural producers, it certainly has a very detrimental effect with respect to our industries and our manufacturing.

One of the ways we have tried to address that problem over the course of the last four to five months is to see what we could do about the fact that we have enjoyed in this country a very strong currency for a period of time but it has become a very difficult problem for us from a trade balance of payments standpoint, from a current account standpoint, and from a trade deficit standpoint.

So we have seen the dollar decline here since our meeting at the Plaza Hotel in New York in September some 20-plus percent against the Japanese yen and 16 to 18 percent against most European currencies. In my view that is going to help our manufacturing industries substantially, albeit we won't see that help for some 12 to 18 months after the decline occurs.

Mr. **CLARENCE MILLER**. You spoke of an increase of about 9 million jobs. Do you have a breakdown as to how many of those jobs might be in services and high tech and how many may be in heavy industry or manufacturing? Give us an idea what direction we are going at this point in time.

Secretary **BAKER**. I will get you that, Mr. Miller. I don't have it here today.

Mr. **CLARENCE MILLER**. If you could get that for the record, I would appreciate it.[1]

Consumer debt is at an all-time high, with Americans owing a total of $664 billion for appliances, automobiles, home improvements and the like. And when we consider home mortgages, we are talking about $1.4 trillion, and this consumer loan and mortgage debt is triple the level of a decade ago. Meanwhile, it is my understanding that the rate of personal savings is around 5 percent of disposable income and 2.8 percent of GNP, much lower than nations such as West Germany and Japan.

What do you see as the reason for our failures to save as much as other industrialized nations?

Secretary **BAKER**. I think one of the main reasons is the fact that we have been running a significantly higher fiscal deficit than many other industrialized nations.

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[1] The information can be found on p. 64.

DEFICIT REDUCTION

Mr. CLARENCE MILLER. Do you see steps that might be taken to encourage greater savings other than reduce the deficit?

Secretary BAKER. Yes, sir. We have proposed significant expansions in IRA accounts as a part of our tax reform proposal. That would encourage savings and encourage them substantially. Our proposals to index depreciation, which is available to businesses and to individuals, would have the effect of stimulating savings.

Mr. CLARENCE MILLER. Do you see any threat to our financial institutions as a result of this high consumer and mortgage debt and low savings rate? Is there not a problem out in the future because of this type of thing?

Secretary BAKER. Mr. Miller, I think for the most part our financial institutions are in good shape. There are some areas of softness, as we know, in the thrift industry but the earnings in that industry are up considerably in 1985 over what they were in 1984 and the outlook generally is better for our financial institutions in the thrift industry.

Mr. CLARENCE MILLER. Mr. Chairman, I used just about my five minutes, and I just want to add that I would hope that we in the legislative body and you in the administration can work together for the American people. We know that we need to get off dead center where we are fighting politics continuously and we need both parties working together to help solve the problem of the deficit and I feel this year that that is going to happen.

Chairman WHITTEN. The gentlelady from Louisiana.

Mrs. BOGGS. Thank you, Mr. Chairman.

It has been said that 1986 promises to be a watershed year for the nation's cities and localities. Various government mandates, the massive budget cuts imposed by Gramm-Rudman and those proposed by the Administration as rescissions and deferrals, and the possible tax code changes all will be hitting the cities in a short period of time.

It has also been said that the combined impact of these major changes will alter the shape and destiny of our nations' cities. For instance, the extent to which this budget, in terminating programs and services for local governments and individuals, relies upon the reduced Communmity Development Block Grant program to respond to needs is just astonishing.

In addition to the programs terminated or reduced in the previous years and piled on the Community Development Block Grant program, the Fiscal Year 1987 budget calls for the CDBG program to handle the needs now being served by the Economic Development Administration, the Farmers Home Administration, the UDAG program, the housing development grant program, the rental rehabilitation program, the housing council program and others as well.

How do you envision cities and localities coping with the major budget cuts they will have to absorb, and most particularly and urgently, how can you expect them to be met in the short term?

Mr. JAMES MILLER. Congresswoman Boggs, in the CDBG, the cut for 1987 is, in terms of budget authority, $3.125 billion, down to $2.625 million, but in terms of outlays the difference is only $20 million, from $3.119 billion to $3.99 billion, so in terms of outlays, there would not be that significant a reduction in 1987.

What we are trying to do is to give the cities and localities and communities more flexibility with how they might use these moneys and these block grants and to accommodate their specialized interest, and we are trying to reduce the overhead attendant with these grants.

Mrs. BOGGS. But you have cut out many of the other programs, and some of these programs you have deliberately folded into CBDG so that with those add-ons and with reductions in the whole program, the Administration is imposing just an enormous burden on the cities.

For instance, in my own city of New Orleans the CBDG budget for this year is $16 million. Before the end of fiscal year 1986 the city expects to drop to a level of $11.3 million. Needless to say, it is going to be difficult to accommodate such an abrupt drop in funding for important services, but it is clearly impossible to accommodate new responsibilities that the budget will impose upon the CBDG program.

Mr. JAMES MILLER. Could I ask for clarification? Is that because of Gramm-Rudman, they dropped to $11 million?

Mrs. BOGGS. It is various things. It is because of the Administration's reductions in its FY 86 budget request, the even lower FY 86 appropriation levels insisted upon by the Senate, and, of course, the Gramm-Rudman reductions.

Mr. JAMES MILLER. I don't—let me, if I could, supply you for the record, because what is published here in our book on this issue, the major policy initiatives' shows no outlay reductions for fiscal year 1986.

So—maybe we could work with——

Mrs. BOGGS. I would be happy to have it.

Mr. JAMES MILLER. We will report back to you.

[The information follows:]

COMMUNITY DEVELOPMENT

Question. The fiscal year 1987 budget calls for the community development block grant program to handle the needs now being served by a number of specific programs being terminated or reduced. How do you envision cities and localities coping with the major budget cuts they will have to absorb, and most particularly and urgently, how can you expect them to be met in the short term?

Answer. Clearly, now that the Congress and the President have endorsed the Gramm-Rudman-Hollings legislation to put into place specific targets for reducing the Federal deficit, some sharp reductions in federal spending are required.

By continuing the CDBG program at a $2.6 billion program level, the Administration is expressing its commitment to continued support of local community development activities. The most dramatic cutbacks occur in the categorical programs you mention. The point is not that all those programs can be funded out of CDBG but that elimination of these categorical programs in favor of retention of CDBG will permit State and local governments maximum flexibility to determine for themselves—in light of their particular circumstances—which activities can be sacrificed most readily and which should be adjusted over time.

The Administration also wishes to meet the demands of truly needy communities. That is why the Administration will propose legislation to target the program more toward communities with the greatest need.

Despite the advantages of CDBG flexibility and future targeting, local spending may need to be cut in the short term, unless supplementary sources of income can be tapped immediately. Over the longer run, we believe communities can adapt to CDBG and other program reductions by making more efficient use of existing resources, developing other sources of income, planning reductions in specific programs, or relying on other levels of government to increase their support of some of these activities.

Secretary BAKER. May I just add to what Mr. Miller has said, Ms. Boggs? When we are talking about the relative burdens with respect to the Federal Government and State and local governments, generally, I think we have to keep in mind that in the aggregate, and I am not talking about New Orleans, and I don't know what the situation is there, but in the aggregate State and local governments are in surplus, and we are $200 billion a year in the hole.

And I think we ought to keep that in mind, particularly, for instance, with reference to revenue sharing. We hear a lot about the consequences of our terminating revenue sharing, but the fact of the matter is the Federal Government simply doesn't have revenue to share with the State and local governments.

Mrs. BOGGS. Unfortunately, Mr. Secretary, we are not in a similar situation, Louisiana has the second highest unemployment rate in the whole country. We are in a very difficult fiscal situation, so we have nothing to share with the Federal Government.

Talking about rescissions and deferrals, Mr. Miller, the Administration has proposed halting the construction of, and the filling of the Strategic Petroleum Reserve. At a time of such soft petroleum prices, that doesn't make such economic sense.

But notwithstanding the merits, the Administration proposed to defer construction funds in fiscal year 1985 and the deferral was disapproved by the Congress.

Subsequently, Congress reaffirmed its commitment to the SPR program by appropriating additional construction funds in fiscal year 1986.

Now, the Administration is proposing a second deferral of the same funds previously deferred, and then made available again by the Congress. Does this second deferral of these funds constitute an illegal impoundment?

Mr. JAMES MILLER. Oh, I don't think so at all. It is a deferral, and we follow the ordinary rules. I understand if the Comptroller believes it is a back door way of trying to impound funds, then he has authority to identify it as rescission. Of course, a rescission doesn't go through unless Congress approves it.

One reason we are coming back again is I think the merits go the other way. The fact the oil price is dropping, you could say now we can fill it at a later price, but the fact the oil prices are dropping means there is less reason to fill SPRO, there is less reason to be concerned about the cutoff.

The cartel is breaking apart. That is the reason the oil prices are falling. So, we believe that it makes sense to top it off at 500 million barrels, and leave it at that.

Mrs. BOGGS. We have very little sense of history if we fall for that kind of thinking, because of current situations. Originally the SPR program was initiated we needed very much to be energy self-sufficient, so as to be strong in Middle Eastern affairs and in the defense of our country, as well as in the defense of the economy of our country.

Mr. JAMES MILLER. I don't remember the specific figures, but at the time in which SPRO was initiated, even 750 million barrels would have held us for a time less than 100 days, because our reliance on imported oil was very much greater.

Of course, our total consumption of oil is down, and our reliance on imported oil is down as well, and as I recollect, 500 million barrels will cover us, our ordinary consumption or the cutoff for like 130 days now.

Mrs. BOGGS. Well, if you remember the economic dislocation that was caused by the shortage, and by the difficulty in distributing during that shortage the supply of oil that we did have, you will know what we cannot afford to ever allow that to happen again.

Thank you, Mr. Chairman. I have additional questions that I will submit for the record.

[The following questions from Mrs. Boggs were submitted for the record. Responses were provided by the Office of Management and Budget.]

Question. Mr. Miller, can we expect the Administration to submit a request to replace the lost space orbitor? If it made sense a couple of years ago to buy two nuclear aircraft carriers at the same time, doesn't it make sense to buy two orbitors at the same time?

[Additional material to be submitted to the Committee for the record.]

Question. Mr. Miller, the Administration proposes to sell off the assets of the Power Marketing Authorities. Realistically, what kind of demand is there out there for additional power generation capacity? Have there been any purchase inquiries? How can we be assured that the people of the United States will receive a fair payment for these assets as opposed to selling them for bargain basement prices?

[Additional material to be submitted to the Committee for the record.]

I am amazed at the extent to which this budget, in terminating programs and services for local governments and individuals, relies upon the Community Development Block Grant program to respond to needs. In addition to the programs terminated or reduced in previous years, the FY 1987 budget calls for the CDBG program to handle needs now being served by the Economic Development Administration, the Farmers Home Administration, The UDAG program, the Housing development grant program, the rental rehabilitation program, the housing rehabilitation loan program, the housing counseling program and others as well.

My own city of New Orleans has a CDBG budget this year of about $16 million. Before the end of FY '86, the City expects to drop to a level of $11.3 million. Needless to say, it will be difficult to accommodate such an abrupt drop in funding for important services, but clearly impossible to accommodate new responsibilities that the budget would impose upon the CDBG program.

Question. Realistically, how can you expect these needs to be met? Most particularly and urgently, how can you expect that they can be met in the short term?

[Additional material to be submitted to the Committee for the record.]

[The following questions from Mrs. Boggs were submitted for the record. Responses were provided by the Department of the Treasury.]

Question. Secretary Baker, the press reports possible changes in the Administration's position on the question of an oil import fee. What is your personal opinion of imposing some sort of import fee at a time of low petroleum prices and don't you think it makes more sense to utilize the proceeds from such a fee to reduce the budget deficit rather than to maintain the revenue neutrality in the pending tax bill?

[Additional material to be submitted to the Committee for the record.]

[The following questions from Mrs. Boggs were submitted for the record. Responses were provided by the Council of Economic Advisers.]

Question. Dr. Sprinkel, is there any real difference in impact on capital markets between the Federal Government borrowing funds and someone in the private sector borrowing funds to purchase some of these Federal assets the President proposes to sell? Doesn't either option crowd other borrowers out of the market?

Answer. Many people believe that Federal deficits tend to crowd out private investment by forcing up interest rates. Investment, however, has been very strong in the current expansion, despite relatively high real interest rates and a continued large Federal deficit. Moreover, empirical studies have not been able to isolate any significant direct effect of Federal deficits on the level of interest rates. In contrast, there is evidence that increases in Federal spending have a positive effect on interest rates. This is probably because increases in Federal spending increase the government's demand on the society's resources—a demand that must generally be met by crowding out private use of these resources. Changes in the deficit, holding spending constant, affect only the way in which the level of spending is financed and not the government's total demand on resources.

Sale of Federal assets to the private sector should have negligible effect on interest rates. Resources must be employed to create new assets, but few resources are used in transferring ownership of already existing assets. Private borrowing to finance purchase of assets presently held by the Federal Government replaces Federal borrowing that has been undertaken for the purpose of holding these assets. The real gain from such asset sales is more efficient administration of those assets in the private sector. Consequently, the gain, in terms of purchase price, will be larger than the Federal borrowing (and lost tax receipts) required to maintain Federal ownership.

Chairman WHITTEN. Mr. Lehman.

Mr. LEHMAN. Thank you, Mr. Chairman.

Mr. Miller, Mr. Baker, I am chairman of the Subcommittee on Transportation, and one of my major concerns is with regards to the Gramm-Rudman reductions of $115 million for operations of the Federal Aviation Administration.

I recognize, of course, that Congress passed Gramm-Rudman. I didn't vote for it, but it did pass, and the President has supported it. However, a cut of this magnitude could force a two-week furlough for all FAA personnel, including controllers, air traffic system maintenance workers, safety inspectors, aviation security personnel, and so forth. If the controllers are not furloughed, then the balance of the FAA staff would have to be furloughed for almost two months.

I am concerned about the impact of these reductions during this current fiscal year if no supplemental is provided.

I guess one of the questions I am asking you is: Do you have in mind a possible supplemental? Let me read you some of the comments about FAA's ability to absorb funding reductions.

"The flexibility available to FAA to absorb reductions and still perform its function simply does not exist. Cuts in the FAA operations budget goes to the very heart of the FAA—it is these monies that provide us with the wherewithal to provide safety for the air traveling public."

These statements were made by the FAA Administrator.

I really find it difficult to understand how the Administration can, on the one hand, say in this fiscal year 1987 major policy initiatives book that aviation safety is one of your highest six priority programs, and at the same time permit a 1986 furlough of air traffic controllers, safety inspectors and FAA maintenance personnel.

Would you explain this to me? I know there was an article in the Wall Street Journal saying they had freezes on different sections of the FAA, but there is $115 million missing.

As the Administrator said, it does cut to the heart of the operation of the agency. It does deal with the controllers, it does deal with the inspectors, and without the possibility of a supplemental I take it we will be in deep trouble.

Mr. JAMES MILLER. Congressman, we do not plan on a supplemental for FAA during this year for 1986 or 1987. For 1987, out of outlays of $4.577 billion, we anticipate increasing total outlays to $4.594 billion, a net increase of $17 million.

The FAA will hire 500 additional air traffic controllers and better train its FAA safety inspectors. It is a high priority item for us. We will also install some of these low-cost but high-technology naval navigation aids, and some of these wind shear safety devices, the NEXRAD, and so forth, so I think we have a high commitment to aviation safety.

Keep in mind, despite some very terrible accidents, I don't want to underestimate the severity of those accidents, we have had a very safe year this past calendar year in commercial aviation.

It is no time to let your guard down. My dad was an airline pilot and believe me, I was very concerned about aviation safety, and I continue to be, but we have been continuing on a track toward safer skies.

Mr. LEHMAN. I understand the numbers, but there have also been some close calls, as you are well aware, that could have gone either way. I am only basing my statement on what your own FAA Administrator is saying, and I would hope that you would work closely with him to be sure that he has sufficient personnel, especially in the areas of air traffic control and aviation safety and security, not just for 1987, but for the rest of 1986.

You could have a serious problem when these furloughs that he anticipates come about. I certainly would want to know when these furloughs are happening before I get on an airplane.

I am sure you would, too.

Mr. JAMES MILLER. Yes, indeed.

Mr. LEHMAN. I have Aviation Daily. I would be happy to discuss possibilities of a supplemental any time you want to.

Thank you very much. Thank you, Mr. Chairman.

Secretary BAKER. Mr. Chairman, before you move on, may I supply the figure Mr. Miller asked for that we indicated we would supply for the record?

Clarence, I think you asked me what the percentage of those new jobs were in——

Mr. CLARENCE MILLER. The nine million new jobs.

Secretary BAKER. Roughly, I think, 70 some percent in the service sector, about 20 percent in goods production—mostly manufacturing—and the rest in government.

Mr. CLARENCE MILLER. That is a little disturbing, but thank you very much.

Chairman WHITTEN. Mr. Coughlin.

Mr. COUGHLIN. Thank you.

We have heard a lot about how the sky is falling. I want to come back and congratulate the gentlemen and the President on the kind of economy we have going today.

In my area of the Delaware Valley, New York, Pennsylvania, New Jersey, Delaware, we have the lowest rate of unemployment in 10 years. This is a remarkable accomplishment, and of course, inflation and interest rates are down. I guess in awe of that we should be able to expect some reductions in the Federal expenditures and various programs.

We have a good economy. I note that in my own State of Pennsylvania, the Governor reported a surplus of $110 million in the budget. Hence, I tend to agree with the Secretary's analysis that there are some things that can be done at the State level and the local level that have not been done.

We all have our own areas of responsibility. I do want to share the Chairman of the Subcommittee on Transportation's concerns about aviation safety. Last year was not a good year in that area.

I think we want to make sure we have adequate safety inspectors. I have to note that if you look at the whole aviation field and the proposed budget, it increases expenditures from 5.3 billion to 5.4, marine goes from 2.2 to 2.4, highways go down slightly, but mass transit takes a real whack, about a two-thirds cut in mass transit. I must say, looking at a balanced transportation system, I see the unfairness of a disproportionate cut in that area.

Can you comment on that?

Mr. JAMES MILLER. Congressman, two things. One, of course, if a State or local government wishes to continue supporting a mass transit system, that is a perfectly reasonable thing to do. That decision should be made locally.

A question may be raised why the Nation's taxpayers as a whole would be paying for a mass transit system in a city far from theirs that they would never use. Another thing is the analysis tends to show, and I think we have learned over the years, that mass transit systems do not operate as efficiently as we once thought they would.

Mr. **Coughlin**. I point out, of course, that city dwellers, where you can't build more highways, do pay for highways in rural areas. I guess it is important to look at mass transit as part of a balanced system. Different things are necessary in different areas, and I hope we will continue to look at that.

Let me ask one question about Amtrak. I am sure you are aware that as you cut out the subsidy to Amtrak, reduce service, and lay people off, you incur labor protection payments. Employees have to be paid for six years at their present wage rate. It ends up costing you more.

This is a contractual obligation on the government, as I understand it. It ends up costing you more than you saved in cutting back on the funding for Amtrak.

How do you figure that into your calculations?

Mr. **James Miller**. Those entered our calculations. I believe our calculations showed it differently, that it would not cost us more to suspend payments to Amtrak than we would save, but you are right, there are some labor protection provisions that do call for outlays for subsequent years.

Mr. **Coughlin**. Are you proposing legislation which would eliminate or modify those?

Mr. **James Miller**. I don't think so, Congressman. Could I get back to you in writing on the details of that?

Mr. **Coughlin**. I think that is important. When this came up with the last budget, we had a difficult problem in that area, because you were costing more than you were saving.

[The information follows:]

AMTRAK LABOR PROTECTION PAYMENTS

Question. Are you (OMB) proposing legislation which would eliminate or modify those (Amtrak labor protection payments)?

Answer. The Administration does not believe that legislation to eliminate or modify Amtrak labor protection payments is necessary. Labor protection benefits are part of the contract Amtrak signed with its employees. Labor protection is the responsibility of Amtrak, not the Federal Government.

In the event of an Amtrak bankruptcy, labor protection costs would be a claim against the corporation. The book value of Amtrak's assets totaled over $3 billion at the end of calendar year 1985. If the entire Amtrak system were shut down, Amtrak estimates that between $2.1 and $2.3 billion in labor protection payments would be claimed against the corporation. Of course, in the event of an Amtrak bankruptcy, the reorganization judge would determine what labor protection payments would be made, if any, considering other claims on Amtrak's assets.

Congress could reduce Amtrak's labor protection costs (currently six-years full salary), just as Conrail labor protection benefits were reduced to a maximum $25,000 severance payment per employee. A reduction in Amtrak's labor protection liability would reduce the claims against the corporation in the event of Amtrak bankruptcy.

Mr. **Coughlin**. Finally, I have difficulty finding in the budget what happens to the operating funding for the Environmental Protection Agency. It seems to be buried.

Mr. **James Miller**. I don't have that broken out, but I will get it for you.

Mr. **Coughlin**. Could you get the broken-out figures for what happens operationally to the Environmental Protection Agency? I can't seem to find that any place in the budget documents.

Mr. JAMES MILLER. Okay.
[The information follows:]

1987 President's budget

	Millions
Operating Programs	[illegible]
State Grants	[illegible]
Regulations/Enforcement	[illegible]
Research	[illegible]
Salary/Expenses	[illegible]
Building and Facilities	[illegible]
Wastetreatment Grants	[illegible]
Superfund	[illegible]
Offsetting receipts	[illegible]
Total EPA	[illegible]

Mr. COUGHLIN. Thank you, Mr. Chairman.

Chairman WHITTEN. Mr. Fazio.

Mr. FAZIO. Thank you, Mr. Chairman.

Let me indicate to you how much we in Congress appreciate the efforts made by you and Mr. Darman to change the Administration's policy of intervening in the money markets and reducing that relative value of the dollar by 20 percent.

I think we need more of that kind of leadership in getting the Administration to take a new course, one that is not so rigidly and ideologically based.

I would like to touch on a couple things just for a moment, maybe a little bit of a potpourri here. I would like to touch on the defense budget, the number issue.

I happen to be on the Budget Committee, as well as the Appropriations Committee, and I can tell you it is very likely when CBO does its reestimates on February 15th, we will find that the $11 billion addition is an accurate one, although I know it is disputed by Director Miller. It is not only the $4 billion reduction that comes about by your using the pre-Gramm-Rudman sequestration level, it is a result of having vastly underestimated the outlay rate on budget authority in a number of accounts.

For example, in the areas of operation and maintenance, research and development and personnel, you come in 30 or 40 percent below what the expectation of the experts around here would anticipate as an expenditure level, as an outlay in the current fiscal year.

So, if CBO backs us up, and they are anticipated to do so, your budget wouldn't be necessarily dead on arrival, it would simply be impossible for us to bring it to the Floor under Gramm-Rudman, because it would not have complied with the mandate that we reach the $144 billion deficit figure.

So, before we even have an opportunity to determine if the Administration is adding $8 or $20 billion to the deficit by missing the projected growth rates by achieving only 1 percent, or maybe 2 percent in GNP instead of 4 percent GNP, we need to straighten out a $15 billion discrepancy. Only then can we start from an agreed upon basis for considering the deficit targets.

I would like to focus, if I could, on some of the things that I think we have got to stop doing if we want to create an aura of good feelings and constructively work towards the compromises we need to make if we want to avoid sequestration in 1987, under Gramm-Rudman.

I was pleased to hear several months ago the Administration's new trade initiative to augment Export-Import Bank funding. But I am disappointed today to see that you are proposing to zero out Ex-Im funding.

I understand the Administration's desire to have a 3-percent real growth in defense in 1987, but I find it difficult to see how that can be accommodated when, as you have indicated in your discussion with Mr. Boland and Mr. Lehman, you have proposed large recissions in 1986, including $9 billion in housing, and billions more in transportation.

You can't have it both ways. If you want the Congress to keep its commitments for future years, the Administration has to keep the commitments entered into by signing appropriations in the current fiscal year.

It is this kind of poisoning of the well that makes it difficult to see how we can reach the compromises that will have to be made. Otherwise, there will be some of the most Draconian cuts in the history of our country made to the Federal budget.

You have proposed a number of what I would term ideological decisions again in this budget. I see Director Miller there. I believe you have your Heritage Foundation tie on today, is that correct?

Mr. JAMES MILLER. No, this is an Adam Smith tie. I wear it proudly.

Mr. FAZIO. Perhaps Adam would be on your side on this one, but let me open up this question. You are proposing to sell off the Elk Hills Strategic Petroleum Reserve at probably the low point in oil market prices, at least in recent history. You are talking about selling power marketing administrations.

I understand in the Western Area Power Administration in my District, the Central Valley Project, which is well along to being paid off, it is currently valued at $450 million by your estimates. That is the price that you are looking for in the sale to the private sector.

But it is actually valued in replacement cost of transmission lines and the dam power development facilities at $4 billion.

In effect, in both cases, if we are talking about a business-like decision, we are doing exactly the wrong thing.

I might just ask you, Director Miller, if you would like to tell us why we would sell off our oil reserves at the low point in the oil market, maybe even a lower one by the time we complete the deal, and why we would be selling off assets like the Central Valley Project in California at about, one-eighth of their true value?

This doesn't seem to be the type of economics or financial management espoused by the Heritage Foundation or Cato Institute or Adam Smith's theories and teachings.

It seems to me if we want to do the business-like thing, we ought to hold on to those assets and let the return, the revenues we are going to derive from them, help us to work out our deficits in the out years.

Mr. JAMES MILLER. My mentality is my own, whatever it is.

Let me say on the question of oil, the markets capitalize future expectations. Under this—it does seem, I guess, at first blush, why could you sell it when the price is low, wait and sell it when the price is high.

The secret to success in selling and exchanging assets is to buy low and sell high. We can't always do that. Why would anyone unload a stock when the price is going down? That would be the sort of argument.

Of course, we know that the people do unload stocks when prices are going down, and sometimes they avoid very large losses, sometimes they make a lot of money by doing that rather than waiting until the price is lower.

The fact of the matter is whatever our future expectations for the price of oil, they will be factored into the market. Whoever thinks the price is going up the most at the margin will be the one that would purchase that asset.

So, it is not a matter of selling it low because the price is low. I think it is just as economic a decision to sell it at a low price as to sell it at a high price.

The question is whether we believe that the price we can get for it is worth more than the current costs on that asset, and I believe that is true, reasonably being for both Elk Hills and Tea Pot Dome. We have other sources of emergency supplies of petroleum, specifically SPRO.

On the question of power, we entered—just as a convention we entered the values for the Power Marketing Administrations at the debt that was owed to the government.

Obviously, this is the value of the Power Marketing Administration on the open market, quite aside from what replacement value would be, because the replacement value grossly overstates market value.

There are other things replacement value grossly understates. But whatever the value is of those on the market, we would hope to secure market value for the U.S. Treasury. If it is eight times the amount of debt outstanding, then we would certainly be better off with respect to attacking the deficit and selling the Power Administrations than——

Mr. FAZIO. Shouldn't you factor in the revenues we won't collect from the sale of that power? They have a present value that needs to be calculated.

Mr. JAMES MILLER. The question is whether the present value of the sale is greater than the present value of those revenues from the out years. As you know, we have had a difficult time in arranging for orderly repayment of the debt during the time that the debt is being repaid, and new loans are being made.

On net for the Power Marketing Administrations, if I am not mistaken, the amount of debt continues to rise. I think it would be a good business deal for the Federal Government and it would be in the end, I think, good for the region as well.

Mr. FAZIO. I think it would be bad deal, and I think we will have to spend a good deal more time on that before the public has much of an impression one way or the other.

Let me conclude by saying, in all of the discussions I have been involved in within the Budget Committee, among my colleagues on both sides of the aisle, we are interpreting the impact of Gramm-

Rudman on the Congress as pushing us in the direction of a 50-50 approach to budget reduction.

In other words, we are going to cut defense and domestic spending from the base line once, when we can accurately determine what the base line is for 1986, pretty much equally.

And I think it is important that the Administration, and certainly the President, understand that the degree to which we can mitigate or prevent those cuts from occurring in equal amounts on both sides of the ledger is going to depend totally on the degree to which revenues become available to prevent that.

Should those revenues not be forthcoming, should the President's feet remain in concrete, as it did not happen in California, then I think it would be fair to say we can right now anticipate deep cuts in both domestic spending programs, not just those programs over there on the charts which are marked in red, which are discretionary programs this committee deals with, but other programs in the entitlement category that go directly to the recipients, as well as defense cuts, certainly not increases of $30 billion. There will be outlay reductions of a very high magnitude, the kind that will do a lot of damage to our national security and provide even more incentive for fraud and waste and abuse in the Pentagon.

I hope you will convey that message, because I think it isn't just coming from one individual Democrat, it is coming from the entire Congress.

Mr. JAMES MILLER. Thank you.

Chairman WHITTEN. Mr. Hoyer.

Mr. HOYER. Thank you, Mr. Chairman.

Mr. Miller, first, I would like to pursue the response you gave at 2:13, referring to the $100 billion in difference between the President's request and the actual appropriations that were made, indicating that the Congress was $100 billion above the President.

Now, I don't have the comparison. I was talking with staff on how to compare that. But with respect to what this committee deals with, appropriated funds, there is obviously a very substantive difference, it seems to me in that figure, and I would like you to speak to that.

I don't know whether you have got any paperwork there that reflects that, but our staff has prepared some figures, and I use them in speeches and therefore, I want to make sure I am right, frankly, which indicate, for instance, in fiscal year 1985, that we appropriated $11 billion less than the President asked for in appropriated funds coming from this committee, and I want to see if that squares with your figures.

For instance, in fiscal year 1985, the President asks for $583 billion in round figures, and we appropriated $571 billion in round figures.

As a matter of fact, over the period fiscal year 1981 to 1986, it would appear that we have appropriated about $2 billion less than the President has asked for over that period of time.

Does that square with your figures?

Mr. JAMES MILLER. I don't have those comparible figures. All I have is the table on page 13.

Mr. HOYER. I can't compare that. That deals with the entitlement program and interest.

Mr. JAMES MILLER. Net interest.

Mr. HOYER. Which, obviously, has gone up faster, probably than any other.

Let me ask you about some parochial matters and follow up on Mr. Coughlin's question. I know it will surprise you. I am going to ask about the Washington metropolitan transit system.

I had a discussion with your predecessor, Mr. Stockman, as to the expenditure of the remainder of the Stark-Harris funds, where it was agreed that the authorization would be expended in $250 million increments through 1989. Last year's budget kept the administration's word by recommending $250 million—and I gave you credit for it and applaud you for it.

The metropolitan region worked hard to develop an agreement on how to build the system within this existing arrangement.

Mr. Stockman responded, I think it was in March or April, that he understood that Metro was a unique system and UMTA subsequently approved this local government arrangement, referred to as the ICCA-IV which proposed expenditures to build an operable system with remaining Stark-Harris funds.

Obviously, now the administration has zero funded the Washington metropolitan transit system. Further, Mr. Stanley, in a lengthy letter two days ago, in a press conference, I guess yesterday or the day before, indicates that he is now going to require additional conditions before releasing already appropriated funds.

My question to you is, am I correct in perceiving the administration has now changed its position with respect to the transit system and the Federal Government's agreement to participate in the build out and release of the Stark-Harris authorized funds?

Mr. JAMES MILLER. Congressman, I was not a party to that earlier colloquy, so I can't comment on it.

Mr. HOYER. Now that you are part of it, how about having a colloquy with me so I can refer to our colloquy in the future.

Mr. JAMES MILLER. Fine. Well, my understanding is the Federal Government has subsidized the Washington metropolitan transit authority to a very substantial tune, and while there have been some success with Metro, the feeling is that the amounts of monies put in the transit program for the overall size of the program and the size of the federal-city share have been sufficient and that if aditional lines, additional operating expenses are needed, it should come from the local jurisdictions, especially in a time of fiscal stringency as we have today.

Mr. HOYER. From my perspective, that is a 180 degree turn for the administration. Based upon Gramm-Rudman, Congress agreed that fiscal times are tough and as a result we are going to need some pro rata reductions and everybody is going to have to tighten their belt across the board.

Tightening the belt and killing altogether the federal participation of the program, I suggest to you, is not what I had in mind, and I don't think the Congress had that in mind.

Let me ask you another question. Consistent with Mr. Fazio's question, has OMB taken a position in terms of privatization in the sale of assets of the Dulles National Airport question that is proposed in the Senate, and legislation pending in the Senate which, in effect, is transferring an asset, two assets worth, according to the Grace commission, somewhere in excess of $400 million and others would say substantially more?

Mr. **James Miller**. My recollection is we continue to support that legislation.

Mr. **Hoyer**. Now, let me ask you, how does that square, when that legislation, I think, calls for less than $50 million in contribution to be paid by the authority to which the two airports would be transferred in the privatization, and the Grace report, of course, recommended the sale of that asset for over $400 million.

I think they said $437 million, but that was, of course, two years ago. How does that square?

Mr. **James Miller**. Well, I don't know off the top of my head how it squared. Maybe the sales price is lower than what the Grace commission had estimated. I simply do not know.

And maybe it is that the administration feels that this bill in the Senate is the best that we can do. I don't know.

Mr. **Hoyer**. Let me, if I can, Mr. Chairman, just two other areas.

The administration is asking, as I understand it, for recission of $600 million for health benefits for government employees for Fiscal Year 1986. Can you tell me the effect of that? That may be too specific a question. I understand that.

I am very concerned about that. I asked the question every year since 1981 when we substantially reduced health benefits on the theory Congress didn't appropriate enough money.

Since then, in 1982, 1983, 1984, 1985, and 1986 budgets, I have specifically asked the OPM whether or not there were sums sufficiently incorporated in the budget to insure the maintenance of health benefits levels at constant levels.

I now see this $6 million recission. Is that because we included more money than we needed in that particular program?

Mr. **James Miller**. I understand this has to do with a rebate, but let me get back to you in writing on that.

Mr. **Hoyer**. One additional question. If you can't answer it, I will understand, but I would like to have you respond to it in the future.

On other cutbacks, these are reductions included in your present budget, in civil service retirement, $15.6 billion over five years is proposed to be reduced, and in federal employee health benefits $4.9 billion over the five years.

Am I to presume the $4.9 billion savings projected is a result of the voucher plan that has been proposed by the administration?

Mr. **James Miller**. I simply don't know. There is a freeze in the COLAs, in the retirement COLAs, and for this year and subsequent years it would be cost of living minus 2 percent. That is our proposal.

Mr. **Hoyer**. I understand that to result in $15.6 billion savings over those three years.

Mr. **James Miller**. Subject to check, I agree.

Mr. **Hoyer**. Thank you, Mr. Chairman.

Chairman **Whitten**. Mr. Regula.

Mr. **Regula**. Thank you, Mr. Chairman. Some quick questions.

Mr. Secretary, first of all, I want to commend you on the G-5 effort, because I think in terms of trade deficits, and currency reform, is it one of the most important elements.

The second key to that is the question of cost of capital. You have seen one of the most modern steel mills in the world in my District, and that is result of the intensive capital investment.

I am interested in your remarks. You mentioned that in tax reform, the cost of capital would be addressed, and I would be interested as to how you anticipate achieving that objective.

Secretary BAKER. We don't have a specific method to achieve that objective beyond the proposal that we submitted as a part of the Administration's tax reform bill, Treasury II.

We have said that there are two major defects in the House-passed bill. There are others, but the two main things we want to correct are the rates, we want to see the rates lower and we don't want to see the depreciation provisions fixed, and we want to see better cost of capital provisions for American industries.

Now, I would refer you to our proposal in Treasury II, which, as you know, improves upon the cost of capital over current law. The cost of capital under Treasury II, had that been passed, would be less overall than under current law.

It would provide, in addition to that, the best rate of depreciation on structures of any of our trading partners, and it would provide the second best rate of depreciation on equipment of any of our trading partners, and obviously, it would also provide American businesses, American corporations with the lowest corporate rate, tax rate, of any of our major trading partners.

So, we don't have a specific provision that we expect to lay on the table in the Senate, we will have to see what the Senate Finance Committee starts with as a mark-up document.

Obviously, we support the proposal that was in the President's tax reform package, and we think that is quite adequate in terms of incentives for capital formation.

Mr. REGULA. In your remarks, you pointed out that the percentage of the GNP going to revenues to the Federal Government has been rather constant, if anything, up a little, but if you factor out the FICA portion of that, has there not been a diminution of the portion of the GNP that goes to other revenue sources for the Federal Government?

Secretary BAKER. Yes, I suppose that is true, but I don't think that is a fair way to look at it. What you have to look at in terms of the impact of the economy, it seems to me, is the total revenue burden.

Mr. REGULA. I understand that. On the question of Treasury financing, what interest rates are you assuming over the next five-year period? Do you see they may fall in terms of debt service cost?

Secretary BAKER. Just a minute, and I will get you the full range of them.

In fiscal year 1987, we are looking on the 90-day T bills, we are looking at 7.3——

Mr. JAMES MILLER. No, that is 1985.

Secretary BAKER. I am sorry, 6.5 percent. In fiscal year 1988, 5.6 percent; in fiscal year 1989, 4.8 percent; in fiscal year 1990, 4.3 percent, and in fiscal year 1991, 4.0 percent.

Mr. REGULA. That is optimistic and good news if it works in terms of capital cost.

Secretary BAKER. Let me say, so far, it is working pretty good.

Mr. REGULA. Mr. Miller, I notice in your statement you talk about a sound and stable monetary policy. How would you describe that? What is a sound and stable monetary policy as you envision it in your assumptions?

Mr. JAMES MILLER. Well, my reference there was to the four-point program that the President announced in February 1981, tax reductions, budgetary restraint, regulatory relief and a stable monetary policy.

One, I think perhaps the thing I would look at first is the rate of growth—the growth in money aggregates, and have a stable growth in money aggregates that is neither too large a rate nor too small a rate.

I think the result of such a policy would be that the value of the dollar would remain rather stable.

The President even mentioned this morning his goal to hold the rate of inflation down to zero—0.0 specifically. I think a sound monetary policy would do that over time.

Mr. REGULA. In your assumptions, in terms of interest cost for financing the debt, what rate of overseas capital flow did you anticipate over the next five-year period?

I think it is about 100 billion at this point in time that is coming in. I wondered what kind of assumption you used perspectively.

Mr. JAMES MILLER. That is not—as I understand it, a direct input into our estimates of the——

Mr. REGULA. It has to be a factor in what the cost of capital will be, particularly in debt financing.

Secretary BAKER. You are talking about investment, foreign directed investment in the United States for the year?

Mr. REGULA. Well, you must use some assumption as to what type of flow there will be from offshore in terms of capital because that reduces the pressures on our own capital markets, and thereby would lower the interest rates.

Secretary BAKER. Well, I suppose they do use it roughly. I will have to dig it up for you. I don't have it right here.

Mr. JAMES MILLER. Our major inputs were interest rate assumptions, and that would affect it. In terms of what specific assumptions were made, I couldn't tell you.

Mr. REGULA. I noticed on page 13 of the highlights you show a declining cost of debt service, so that would have to be predicated on a lower interest cost in the rollover of the Federal debt.

Mr. JAMES MILLER. We show the GNP deflator ticking up slightly for 1987 to 4.1, and then falling to 3.6, 3.2, 2.5 and 2.0.

Mr. REGULA. Thank you, Mr. Chairman.

Chairman WHITTEN. Mr. Coleman.

Mr. COLEMAN. Thank you for being here this long afternoon. I wanted to start out asking a question that might sound parochial, but I think important to the entire country. It concerns our efforts to improve drug interdiction, and facilitate trade and commerce between Mexico and the United States.

I am alarmed you recommended in excess of a 10-percent cut in Customs personnel in this budget. First of all, do I understand you used a base of 14,041 Customs personnel as the number from which you began to subtract Customs personnel for next year?

Secretary BAKER. Yes. We did begin with a base of 14,041 FTEs for the Salaries and Expenses appropriation.

Mr. COLEMAN. I am talking about FTEs, that is right.

Secretary BAKER. That is correct.

Mr. COLEMAN. Yes, sir.

It was part of the continuing resolution.

Secretary BAKER. 14,041.

Mr. COLEMAN. The language states, "none of the funds made available by this Act shall be available for administrative expenses to reduce the personnel level of the Customs Service during fiscal year 1986 below an average of 14,041 full-time equivalent positions."

Secretary BAKER. We agree with that.

Mr. COLEMAN. And in this budget you subtracted from that 1446 positions, is that correct?

Secretary BAKER. Well, the Gramm-Rudman reduction is 777 FTE for salaries and expenses.

Mr. COLEMAN. So you subtracted 777 because of Gramm-Rudman for March? Is that what you anticipate as the loss of FTEs in Customs?

Secretary BAKER. Yes.

Mr. COLEMAN. What percent was that cut, in terms of FTEs full-time employees—4.3 percent?

Secretary BAKER. 4.3 is what we had to apply to the funding level, however the staffing reduction equals a 5.5% reduction.

Mr. COLEMAN. 4.3 would be 608 FTEs. The reason I request these numbers, is that every one of these positions, is extremely important, as you know probably better than anybody else, Mr. Secretary. There are border crossing all along our border with Mexico and these positions are extremely important. They are important to ports and air terminals all across this country.

Secretary BAKER. Congressman, I just have to sit down with you, which I will be delighted to do, or have the staff, and tell you exactly how we get to these levels. We are spending $1.8 billion in the drug effort in this country. We are suggesting in this budget, in spite of the fiscal restraints that we are under and the budget restraints we are under, we are very happy, as a matter of fact, to be able to come in with a Customs budget that would represent an $11 million increase over our revised fiscal 1986 budget.

Now, in an ideal world, maybe we would be higher than that. But I will be glad to get with you, if we can, after this hearing and go over these specific numbers on FTEs.

Mr. COLEMAN. In operation and maintenance of the air interdiction program, you are requesting reduced funding from $75 million in fiscal 1986 to $54.7 million in fiscal year 1987.

Mr. JAMES MILLER. Could I mention, while there have been some changes in the mix by which we go about interdicting the importation of drugs, the agencies that are involved in this, we actually, in this time of fiscal restraint, are increasing functions some $146 million above current services. As the Secretary just indicated, we are spending $1.8 billion on drug enforcement this year—we are proposing that for 1987.

Mr. COLEMAN. I understand the FBI and DEA receive increases of about 11 percent under the budget. On the other hand, we take away from what we both referred to, Mr. Secretary, last year, when we were here, as the "front line" against drugs and agreed they shouldn't be diminished. And, in fact, we wound up in the final analysis with the President signing legislation with an increase, finally, of that front line war against drugs. With those Customs agents, we have finally seen some beginning of improvement.

This budget looks like we are taking a step backwards as far as those front-line troops in this war on drugs are concerned. I would hope we are not going to increase DEA and FBI on the one hand, and turn around and cut Customs personnel 10 percent with the other. It seems to me to be counterproductive, and I would like very much to see that those increases are not made at the expense of another law enforcement agency. I think they are extremely important.

I hope we are not helping one agency at the expense of another agency, when in fact I think that from all the testimony we have heard from the Government Operations Committee, the Armed Services Committee, this committee, and the Select Committee on Narcotics, we can show you that would be a mistake.

And I look very forward to, to deal specifically with these kinds of numbers, because I think that these cuts are really a mistake if, in fact, we are serious about this war on drugs. I don't think you can fight it with the FBI and DEA alone, I think we are going to have to do it with a lot of different agencies and fight it on a lot of fronts. I think we all recognize that.

Once again I am concerned that the administration has decided to rescind funds appropriated to the Emergency Immigrant Education program. At that time I was answered by Mr. Stockman with respect to that, and that was when I suggested reasonable minds, and not regional but reasonable minds, could agree that this was indeed a Federal program, and that it was wrong to ask only local taxpayers to pay the additional expense of educating the children of undocumented workers. It is a minor reimbursement to those states with local school districts incurring an influx of three percent or 500 children of undocumented workers living here.

In 1983 and 1984, Congress passed authorization and funding for this program because Congress recognized the states and local school districts were being penalized for the Federal Government's inability to control our international borders. Yet for the third year in a row, the administration is seeking to terminate this program through a rescission. Congress has rejected that in the past, and yet the administration persists.

Why is there no recognition that the Congress feels very strongly about this particular issue? Is there a rational reason for this kind of a rescission?

Mr. **James Miller**. Well, at any point I think the administration will, as you go through the budget, evaluate programs and make proposals for changes. That is what the budget process is all about from the standpoint of the administration and proposing changes to Congress, changes in policies. The fact of the matter is that the refugee and entrant caseload has really decreased rather remarkably from a level of 210,000 in 1980 to 67,000 estimated for fiscal year 1986, and for that reason we believe that the level of funding justified was a lot smaller.

Mr. **COLEMAN**. Those are two unrelated issues. I would hope that is not the basis on which you would make a decision about a rescission of the Emergency Immigrant Education program.

Let me point out, if I could, when we were dealing with the Simpson-Mazzoli immigration bill two years ago, the conference didn't come out with a bill and in my opinion the real reason for that was a failure on the part of the administration, and a failure maybe on the part of Congress, and the failure was that there was no commitment whatsoever to reimburse units of local governments and states for what was going to happen to them. It is easy for us to say, yes, these are great laws and this is what we ought to do, and, sure, you should educate the children of undocumented workers. However, you have to pay for it, and I think that is the problem we are all agreeing with in all the questions I have heard today.

If we are against drugs, we are going to have to pay for it, aren't we? I think that is the problem, I think that is where this country is headed. If we are not willing to pay for the things we say we want to do or have as a nation, then I think we are in real trouble. I am just hoping in terms of immigration, the administration would not base it on some other unrelated factor which you did in terms of refugees.

I would like to take you to the border. I will show you the number of children of undocumented workers in the local school districts, paid for by the local taxpayers. I don't think you will find they have gone down or decreased. The statements we see every day are the number of new immigrants into this country rises. I think that is the problem. You are right, they didn't go through the INS.

Mr. **JAMES MILLER**. Mr. Coleman, I obviously misunderstood the question you were asking. Let me get back in writing to you on this.

[The information follows:]

RESCISSION OF FUNDS FOR EMERGENCY IMMIGRANT EDUCATION

The Emergency immigrant education program provides Federal subsidies to school districts that enroll substantial numbers of recent immigrant children, not all of whom are children of undocumented workers. These same districts receive funding under a variety of other Federal programs most of which concentrate funds on students that are educationally disadvantaged. Such programs include Chapter 1 compensatory education grants, Bilingual education, Handicapped education, and the Chapter 2 block grant. Children of undocumented aliens are eligible to receive services under these programs as long as they are in need. We believe the substantial funding available through these other programs adequately compensates local school systems for the cost of educating immigrant children.

Secretary **BAKER**. Let me add, too, if I could, Congressman, we are paying for the fight against drugs, it seems to me. Nobody is suggesting we not pay for the fight against drugs. We are spending $1.8 billion a year. I am rather proud, as a matter of fact, of the fact we are able to increase the Customs Service's budget, albeit a small amount. It is not as much, perhaps, as some would like, but we are able to increase it. We are able to stabilize and not see any decrease in the air program.

So I would submit to you that we are not neglecting the war on drugs, and we are spending in order to combat that very difficult problem.

CUSTOMS USER FEES

Mr. **Coleman**. This will be my last question, Mr. Chairman. The budget claims about a $520 million offset against expenditures based upon Customs user fees. I have a specific question about it. What kind of user fees are those going to be? Are those going to be the kind we had in H.R. 3128, the 1985 Reconciliation bill? Are those the kind where you are going to charge a $5 fee for every vehicle that crosses and $1 for every pedestrian that crosses across the border?

Secretary **Baker**. Yes.

Mr. **Coleman**. You are going to attempt to collect $1 from every person who comes into the United States?

Secretary **Baker**. I don't know what the amount is per crossing, but I think part of those user fees are fees for the maintenance of those posts and installations.

Mr. **James Miller**. A scale according to the value——

Secretary **Baker**. It is not unlike a fee to visit a national park.

Mr. **Coleman**. Let me say to you Mr. Secretary, those of us who represent the border area do so in bipartisan spirit. And I would love to sit down with you and the Border Caucus and discuss the practicality of that. We had the Department of Transportation down in my district last week saying DOT can't enforce the statutes about safety and insurance in the Motor Carrier Safety Act of 1984 as they relate to cross-border trucking. I mean, it is just unenforceable.

We don't want to stop traffic, between our third largest trading partner and us, I don't think that is good. In those areas of poverty and high unemployment alone, along our border of Mexico, I would hope what we would want to do is increase the possibility for border traffic. I think that benefits us greatly.

Secretary **Baker**. I agree, Congressman, but nobody is suggesting stopping traffic, and a modest user chart, we have got to put this Government on a pay-as-you-go basis. And we are not—you said it yourself—we are not willing to spend the money we have to spend and nobody is suggesting stopping traffic.

Mr. **Coleman**. When I suggested to you talking, I don't mean let's not do it, let's talk about how to do it. One of the suggestions that came out of Mr. Gibbons' Subcommittee on Trade was that we wouldn't charge the pedestrian, but that we would charge the businesses, we could charge all those corporations based in America utilizing—a Maquila type project, a twin plant. We agreed to charge them a maximum of $100 a year, and I think you would find them willing to do that.

Are you going to stop every one of them and get $5 out of the cab of the truck?

Secretary **Baker**. We submitted a proposal, and we would be delighted to work with the Congress to see how to best implement those user fees.

Mr. COLEMAN. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

CLOSING STATEMENT

Chairman WHITTEN. There are several matters I have postponed until now. One of them is this idea we have of putting things back on the people of the States. We tried that under the Articles of Confederation where the States looked out only for themselves and it didn't work. The main things we have in this country today of which we are proud came about because we are a United States. That is the reason the name says that in the title. The citizens of the States are citizens of the whole country.

To say we put it back on the States—when they are in the same shape or worse shape than we are—doesn't hold with me. Let me just point out there are a number of things I have a hard time getting over to my colleagues. Over 80 percent of this country is what is classified as rural. The Farmers Home Administration has so many things that they have to do, with time it became evident if these rural areas weren't tied in with the cities, they wouldn't get anything.

When I came here they had passed a housing bill, but they hadn't made a single loan in rural areas because, they don't have the same facilities with which to get a loan and the only way that you can see they get equal treatment, because you don't have banks and others willing to get into these rural programs, is to have a separate program. Now that comes from experience.

Now, I was responsible initially I guess, for a good deal of it, because these programs that come along, the Farmers Home Administration was best able to handle the program instead of other agencies of the government.

I was one that sponsored the Budget Committee, because 42 percent of the spending was going around our committee.

After 10 years, 46 percent. When all is said and done, this is the committee that comes up with the money to do what is the recommendations, with the assurance that it will come up.

I want to point out, in 1973, 1974 and 1975 and 1980, to punish Russia or somebody else, we restricted the export of farm commodities. If I couldn't deliver, you paid me, but you didn't pay the farmer.

The law calls for us to offer in world trade whatever we got, and don't need. Every country does that except us. That is the farm problem. You may not pay attention to it, but I pointed out these facts with basic commodities, and it passed through the House before Christmas, called on a return to where the user pays the price and not have the farmer go to Appropriations, where they have to compete with other committees.

I am proud of rural electrification, rural roads, rural housing, it has made rural areas somewhat of an equal with cities in certain situations, but we see more and more where the Budget Committee and others are cutting out, as you remember, all the money that goes into housing.

I have been on Defense since 1943, I have been on just about every subcommittee, but equal treatment to people of this country is what we should see, and unless you have a way to offer something better, I want to say I appreciate you coming here.

You have a different background, and a different problem. As chairman of this committee, I have a lot of folks telling me what to do.

Mr. Miller and Mr. Baker, I thank you all. I thought we handled the continuing resolution better than ever. Unless we get stubborn, it would be easier, and I thank you both, and you, Mr. Secretary, we have to get together.

This Nation, with the Executive, Judiciary and Legislative, like the old Roman chariot with three horses, if you don't pull in the same direction, you are not going anywhere.

Of course, we are trying to get you to change direction. We don't expect to win them all, and thank you for being here.

I think this hearing has gone better than others in that we had a little thought to planning. I never have tried my stuff in the newspapers, so whenever you want to talk to me, I hope you will talk to me.

Thank you very much.

[The following questions from Mr. Akaka were submitted for the record. Responses were provided by the Office of Management and Budget.]

Question. Mr. Miller, with regard to your GSA real property sale proposal, identify all federal properties in Hawaii which are eligible for sale in FY 1986 and FY 1987? For each, give the name of the property, its location, the total size of the property, size of the parcel eligible for sale and improvements, if any.

[Additional material to be submitted to the Committee for the record.]

Question. Mr. Miller, of the above properties, identify those which will be proposed for sale in FY 1986 and in FY 1987. For each, give the name of the property, its location, the total size of the property, size of the parcel proposed for sale and improvements, if any.

[Additional material to be submitted to the Committee for the record.]

Question. Mr. Miller, provide the targets proposed by the administration in its budget submission for federal real property sales for each fiscal year from 1981 to 1988 (dollar value and acres).

[Additional material to be submitted to the Committee for the record.]

Question. Mr. Miller, provide the actual sales of federal real property completed by GSA (*i.e.* actual transfer of title to the property) for each fiscal year since 1981 (dollar value and acres).

[Additional material to be submitted to the Committee for the record.]

[The following questions from Mr. Akaka were submitted for the record. Responses were provided by the Department of the Treasury.]

Question. Secretary Baker, what steps have you taken to implement the following directive in the Conference Report to accompany the Treasury-Postal Service and Related Agencies Appropriations Bill (H. Rept. 99-349)?

The Conference direct the Customs Service to report by March 1, 1986 on the feasibility of establishing preclearance of Japanese travellers bound for Hawaii. In preparing its report, the Customs Service shall solicit the views of the State of Hawaii and Hawaii's travel industry and make those views available to the committees with its report.

Answer. In December, soon after *Aviation Daily* reported that the Conference Report included language asking for a feasibility study of preclearance from Japan to Hawaii, Customs began receiving correspondence from representatives of the Hawaiian travel and tourism industry. We have received 17 letters to date offering their strong endorsement of such a proposal. The Governor of Hawaii also wrote to add his strong support for preclearance as a way to make it easier for people to visit Hawaii and the United States. He indicated he had met government officials in Japan while on a recent trip who expressed an interest in pursuing further discussions. His office advised U.S. Customs he would be willing to reestablish those contacts if the Customs report viewed preclearance as feasible.

However, the Department of State, while in Tokyo discussing the bilateral aviation agreement, advanced preclearance as a topic of discussion. The head of Japanese Customs and the head of the Japanese equivalent of their Department of Transportation indicated they had no knowledge of planning for preclearance at Tokyo. The host government expressed no interest in establishing U.S. preclearance in Japan.

The Department of Transportation has provided travel statistics and the Immigration and Naturalization Service has reported on preinspection in Japan. The results of this analysis will be detailed in the report due to Congress.

Customs also studied flight schedules and carriers' equipment usage on the Japan-Hawaii routes. It is clear that these carriers must provide strong commitment to this kind of preclearance in order for the Federal Inspection Service officers stationed abroad to be effectively utilized. One concern is that Hawaii would be the prime beneficiary and, consequently, the number of inspection personnel there would be reduced in order to provide staff in Japan. Another factor is that many Hawaii-bound flights from Japan actually originate at other foreign stations. When these flights embark precleared passengers at Japan, those passengers already aboard and their baggage must deplane and undergo preclearance processing also.

Customs sets certain minimum workload requirements for establishing new preclearance sites. Copies of these requirements are included.

ESTABLISHMENT OF PRECLEARANCE SITES

I. POLICY STATEMENT

The Customs Service is fully supportive of preclearance in those locations where the traveling public, air carriers, and Federal Inspection Services (FIS) agencies benefit from the activity. Preclearance should be cost and resource effective to Customs and provided at no cost to the taxpayer. It should not hamper our enforcement objectives. It should expedite passenger flow and relay or alleviate congestion at U.S. airports.

II. LAW ENFORCEMENT AUTHORITY AND ASSISTANCE

Because preclearance inspectors are on foreign soil, they do not have search, seizure or arrest authority. This means that Customs must rely on local agencies for their support of the United States law enforcement goals.

III. REQUIREMENTS TO ESTABLISH A PRECLEARANCE SITE

A. Bilateral agreement between the U.S. State Department and foreign country. The agreement should protect U.S. interests and afford Customs employees standard diplomatic protection. The document should ensure that adequate facilities and security are maintained in the FIS/IAB (International Arrivals Building) area, and that the host country acts promptly to correct problems brought to their attention.

B. Airlines' agreement to participate in preclearance and pay specific excess reimbursable costs. All excess preclearance costs are paid by the air carriers.

C. A minimum passenger flow of 162,000 per year.

Customs has set this number as a reasonable workload to keep our staff efficiently occupied, and contribute to maximum utilization of resources. This figure may be raised upward to accommodate new passenger processing methods.

D. Facilities which conform to FIS requirement.

The host government must provide facilities which meet FIS standards for passenger processing.

E. Available human and budgetary resources to staff the preclearance site.

Since preclearance staffing comes out of our overall personnel ceiling, we cannot staff preclearance at the expense of domestic operations.

IV. BENEFITS

Preclearance is beneficial because it allows us to screen relatively low risk arrivals on-site and allows Customs to direct our resources to higher risk arrivals. Since most precleared arrivals come into domestic gates, congestion in international arrival areas is reduced and higher risk flights can be targeted for intensified examinations. In FY 84, 4.8 million persons were precleared into the U.S. from nine foreign sites.

Question. Secretary Baker, what steps have you taken to implement the following directive in the Conference Report to accompany the Treasury-Postal Service and Related Agencies Appropriations Bill (H. Rept. 99-349):

> *Provided further*, That none of the funds made available by this Act shall be available for administrative expenses to reduce the personnel level of the Customs Service during fiscal year 1986 below an average of 14,041 full time equivalent positions. (And all that follows through the end of the report language on Amendment number 19 including the directive to give highest priority to those locations identified in House Report 99-210 and Senate Report 99-133.)

Answer. The deficit must be reduced. Both the Administration and the Congress agree on that. Given the deficit situation, agencies must take their share of reductions, the Customs Service included. For FY 1986, this amounts to a reduction of $55 million and over 770 average positions for Customs. Obviously this does not allow the Customs Service to maintain 14,041 average positions. This is not to say that Customs is ignoring congressional priorities. As internal staffing reallocations occur based on changing priorities and workload shifts, Customs will attempt to comply to the extent possible with congressional concerns and to maintain or increase staff in the most critical areas.

Question. What steps have been taken to implement the directive in the Report to accompany the Treasury-Postal Service and Related Agencies Appropriations Bill (H. Rept. 99-210) regarding sugar drawback fraud?

Answer. Steps were taken immediately to cease making accelerated payments and not liquidate any drawback entries of sugar. Targeted companies were identified and Customs field offices were notified. U.S.D.A. officials met with Customs officials to draft a new proclamation which required proof of exportation for the reexport program. Some documents were fraudulent and hard to detect, but all were checked that could be checked. Spot checks were made upon exportation. Audit verifications are provided by regulation and drawback has been given greater priority.

Customs is practicing selectivity while at the same time looking for clues as to fraudulent intent. The exporters summary procedure is one area on which we keep a closer watch. Customs personnel have notified the fraud teams regarding individuals who become suspect and identified areas or locations where activities need greater surveillance.

Customs is also conducting Operation BETTERSWEET, an investigative effort relating specifically to sugar drawback fraud. So far, the resultant major criminal fraud cases have accomplished the following statistics:

Indictments:	
Corporations	15
Individuals	16
Arrests	24
Convictions:	
Corporations	14
Individuals	12
Recoveries to date	$1,648,323
Criminal fines	$170,000

The operation is still in progress and additional indictments will be forthcoming.

Civil fines and penalties will be issued after the civil actions are complete.

Question. Secretary Baker, the report language contained in H. Rept. 99-210 requires the Customs Service to submit a report to the Appropriations Committees on sugar drawback fraud. Please submit a copy of this report, for the record.

Answer. Unfortunately, Customs overlooked the requirement for the study; but as discussed in detail, previously, Customs is taking corrective steps to prevent the recurrence of sugar drawback fraud. In response to the request of the Committee, a report providing the details of Customs plan of action to prevent this problem from recurring will follow at the earliest possible date.

Question. Secretary Baker, on January 9, Customs issued a Textiles and Textile Products Directive (3500-06) requiring the filing of a formal entry on all shipments of textiles regardless of value. Evidently, this action was taken in response to concerns that "increased abuses and the circumvention of quota restraint levels by many countries by the improper use of "exempt certifications" for textile shipments valued under $250 in value, require greater and more knowledgeable scrutiny of these shipments."

A November 1985 Customs study revealed that the potential for abuse of the "exempt certifications" entry system for small textile shipments may be great. From evidence presented by Customs, there is no doubt that exempt certifications have been used by certain individuals to circumvent quota restrictions. However, I question the wisdom of Customs reacting to the matter in what appears to be a rash fashion.

Recognizing the nature of the textile-importing business including the need for long-range planning on the one hand and the short shelf life of many textile products, would it not be reasonable to allow textile importers a fair, reasonable adjustment period before implementing the directive? (One month grace, as currently provided, is not adequate.)

Evidence cited by Customs reveals abuses in the importation of apparel products. It is clear, therefore, that such products should be monitored. However, are the problems concerning the importation of textiles equal in magnitude? If not, why threat both these segments of the industry the same way.

Answer. Customs has delayed implementation of the Customs Directive on the new entry requirements for sixty days from the date of its issuance, namely March 9, 1986. This delay was appropriate in order to minimize the impact on innocent parties. At the same time, in order to pursue those individuals involved in abuses, no further delay was acceptable.

Customs has met a number of times with members of the importing trade to settle on viable proposals to meet the problems they have conveyed to us, e.g., imported textile samples, etc.

The textile abuses and quota circumvention found by Customs apply equally to textiles and apparel.

[The following questions from Mr. Boner were submitted for the record. Responses were provided by the Office of Management and Budget.]

Question. Each year during the Committee's overview of the budget, I have had the opportunity to ask the witnesses why the President has not submitted a balanced federal budget, given his clear and consistent support for legislation requiring one. Why has not the President submitted a balanced federal budget?

[Additional material to be submitted to the Committee for the record.]

Question. What administrative actions have been taken to prevent federal agencies from spending or obligating the balance of their funds in the last quarter of the fiscal year in order to avoid having to return the funds to the general treasury?

[Additional material to be submitted to the Committee for the record.]

In December, the Air Force Logistics Command ordered its procurement officers to spend as much money as possible in the last 10 days of 1985. As you know, the sequester baseline for defense programs under Gramm-Rudman-Hollings includes unobligated prior year balances against which the percentage reductions are made. News reports quoted the Air Force as having more than $700 million left over from prior years' spare parts budgets. I have several questions, the answer to some you may provide for the record:

Question. Prior to the issuance of the Air Force's December "buy order" were there any discussions in the Pentagon or between OMB and the Pentagon on reducing unobligated prior year balances as a way to lower the Gramm-Rudman sequester baseline?

Question. How much did each of the Armed Services spend in the last month of 1985 and how does that compare with the monthly average for the prior fiscal year for each Service?

Question. After the Air Force "buy order" was issued, how much money from prior years' appropriations was obligated prior to the end of the year? How much for the other Services?

[Additional material for questions 1–3 above to be submitted to the Committee for the record.]

[The following questions from Mr. Boner were submitted for the record. Responses were provided by the Council of Economic Advisers.]

Question. Under Gramm-Rudman-Hollings, of course, Congress has set forth a specific path toward reducing the deficit by 1991. Assuming current economic assumptions continue unchanged, and assuming Congress does not increase taxes nor achieve outlay reduction greater than that required to reach Gramm-Rudman deficit targets, do you believe that there is any negative economic impact resulting from Gramm-Rudman reductions?

Answer. This question, I believe, was dealt with in my prepared statement, but let me expand briefly.

The evidence suggests that reductions in real Federal spending have a small and short-lived negative effect on the level of economic activity. The largest reduction in real government spending called for by Gramm-Rudman-Hollings, however, is only about one-half of one percent of U.S. real GNP and occurs between fiscal years 1986 and 1987. This cut will occcur when, for the reasons outlined in my statement, we expect other forces to be maintaining a good rate of economic growth.

Question. All other things being equal, how much of a single-year's deficit reduction is, in your estimate, too much, thereby resulting in a negative effect on the economy?

Answer. If the deficit reduction is achieved by cutting spending or reducing its rate of growth, there should be a long-run positive effect on the economy because more resources will be employed in the private sector where they are generally employed more efficiently. If the deficit reduction is achieved by raising taxes, the long-run effect on the economy would be negative because higher taxes diminish incentives to work, save, and invest. With respect to short-run effects, there would be cause for concern if we attempted to eliminate the entire deficit in a single year through a cut in real Federal spending equal to approximately four percent of real GNP. However, Gramm-Rudman-Hollings does not require such sudden cuts. After the real spending cut of about one-half percent of GNP between fiscal 1986 and 1987, little further change is required in the level of real Federal spending to reach the target of a balanced budget by 1991, provided that the economy performs along the path projected by the Administration.

Question. In the fact of the President's proposed fiscal restraint, there is a serious question whether monetary policy can be adjusted in a timely way to sustain economic growth. By design or otherwise, the Federal Reserve is reluctant to take a lead in reducing interest rates through changes in monetary policy. What is the Administration assuming in its GNP, revenue and interest rate forecasts about the pace and direction of Federal Reserve monetary policy?

Answer. We assume that the Federal Reserve will gradually reduce the rate of monetary expansion over the next six years, leading ultimately to the goal of price stability. Continuation of the rate of monetary expension in the range prevailing in 1985, about 12 percent per year, would, in my judgment, pose significant danger of regeneration of inflation. Experience indicates that sudden slowdown in the rate of monetary expension increases the risk of recession. To limit this danger, while moving toward the longer term objective of price stability, the Federal Reserve should reduce gradually the rate of monetary expension.

I would not recommend any specific adjustment of Federal Reserve policy in the light of actions to reduce the Federal fiscal deficit in accord with the targets of the Gramm-Rudman-Hollings Act. As I said previously and in my written statement, we do not expect that the real spending reductions necessary to meet the Gramm-Rudman-Hollings targets pose any significant danger of slowing substantially the rate of economic growth. Moreover, monetary policy affects the economy with a lag. Consequently, as a general rule, I would recommend against altering monetary policy in efforts to fine tune the performance of the economy.

Question. Is the Administration implicitly assuming further accommodations in monetary policy from the Fed in order to achieve your revenue, interest rate, and GNP assumptions? What are your expectations about future Fed monetary policy?

Answer. As I explained in my answer to the previous question, the Administration's projections for economic performance over the next six years assume that the Federal Reserve will gradually reduce the rate of monetary expension along a path that avoids a money-induced recession and that is consistent with a gradual reduction in the inflation rate after a small upturn in 1986–87. The projections of economic performance for 1986 to 1991 depend on this assumption about monetary policy. These projections, in turn, affect the estimates of Federal revenues and expenditures that appear in the Budget. Pages 2–15 to 2–30 of the Budget provide more information about the relationship between expected revenues or expenditures and projected economic performance.

Question. Examining your economic asssumptions closely and comparing your relatively stable CPI inflation estimates and your declining three-month T-bill rates, I would like to know what your assumptions are for real interest rates and whether the Administration believes real interest rates are high and, if so, how high?

Answer. If I use the GNP deflator, rather than the Consumer Price Index (CPI) as a measure of inflation, I can answer this question by referring to the table that appears at the end of my written statement. The projected short term real interest rate for any year may be calculated by taking the difference between the average projected value of the 91-day Treasury Bill rate for the year and the projected value of the fourth quarter to fourth quarter percentage change in the GNP deflator. The projected short-term real interest rates are as follows: 3.5 percent for 1986 2.4 percent for 1987, 2.0 percent for 1988, 1.6 percent for 1989, 1.8 percent for 1990, and 2.0 percent for 1991.

These figures should be interpreted as a projection of a continuation of downward trend in real interest rates from the quite high rates experienced in the early 1980s. I believe that as the public has become more firmly convinced that the battle against inflation is being won, real interest rates have tended to decline, and that further declines will occur as more progress is made keeping inflation low and in reducing it further.

Even at 2.0 percent in 1991, the real interst rate on short-term Treasury Bills would be somewhat above its historical average of somewhere beween zero and one percent. In the longer term, as confidence in the restoration and maintenance of price stability is established, further progress in reducing real interest rates may well be possible.

[The following questions from Mr. Green were submitted for the record. Responses were provided by the Office of Management and Budget.]

Question. To turn to the spending side of the equation, the Administration makes much of the fact that federal spending has risen from 22% of GNP in 1980 to 24% today. But is it not true that the defense segment of that spending has risen in the period from 5.0% to 6.4% of GNP and Social Security spending has increased from 4.3% to 4.7% of GNP, so that all other federal spending has remained constant at 12.9% of GNP?

[Additional material to be submitted to the Committee for the record.]

Question. Under those circumstances, why does the Administration seek to make non-defense, non-Social Security spending the villain of the piece? If defense and Social Security spending as a percent of GNP account for the increase in federal spending as a percentage of GNP, and federal revenues other than the Social Security tax have been declining as a percentage of GNP, are not those the factors that have created the deficit, and should we not be focusing on those factors as we seek to deal with the deficit?

[Additional material to be submitted to the Committee for the record.]

[The following questions from Mr. Green were submitted for the record. Responses were provided by the Department of the Treasury.]

Question. Mr. Secretary, the Administration makes much of the fact that current federal revenues as a percentage of Gross National Product, approximately 19%, are in the same range as they have been since 1964. But is it not true that the mix of revenues has changed significantly over time, so that currently a higher portion of revenues is dedicated to the Social Security System than was true in the past, while a smaller portion is available for other purposes? For example, in 1964, when federal revenues amounted to 17.9 of GNP, Social Security taxes amounted to 3.5% of GNP, leaving federal revenues amounting to 14.4% of GNP for other federal purposes. By 1979, when federal revenues were 18.9 of GNP, Social Security taxes had risen to 5.7% of GNP, leaving only 13.2% of GNP available for other purposes. Today, with federal revenues at 18.6% of GNP, 6.7% of GNP is dedicated to Social Security, leaving only 11.9% of GNP in revenues available for other purposes. Is that not a fact?

Answer. The important fact is that the aggregate tax share of GNP has remained relatively constant. Social security taxes have risen as a share of the total because of an extremely rapid rise in social security benefit payments. Taxes lower disposable income and reduce private incentives to work, save and invest whatever particular form they may take or to whatever specific purpose they may be dedicated. Therefore, in analyzing the contribution of expenditure and tax trends to the current budgetary situation, attention is properly directed to the total tax burden—including social security taxes—all of which inevitably comes to rest on the private sector and exerts an adverse effect on incentives for productive activity.

[The following questions from Mr. Roybal were submitted for the record. Responses were provided by the Office of Management and Budget.]

Question. The Budget proposes to eliminate funding for revenue foregone in the Postal Service. What impact will that have on the postal rates for the non-profit mailers to raise funds to help the sick, poor, and aged?

[Additional material to be submitted to the Committee for the record.]

Question. The Budget proposes to reduce U.S. Customs personnel by about 1,500 positions, including the impact of Gramm-Rudman and the proposed rescission of FY 1986 funds for Customs. What impact will this have on Customs' ability to interdict narcotics and process incoming passengers and cargo?

What impact will such a large reduction have on the revenue generated by Customs?

What was the amount of revenue generated by Customs in FY 1985?

[Additional material to be submitted to the Committee for the record.]

Question. For several years you have been telling the Committee that you could "do more with less". Is that still your philosophy?

[Additional material to be submitted to the Committee for the record.]

Question. I agree with the Administration's stated position that the control of drugs is extremely important to our country. Just yesterday, I personally heard Attorney General Meese say that the control of drug trafficking was the nation's number one law enforcement priority. The budget documents themselves point to the enforcement of our drug laws as a high priority and one of the Administration's "major policy initiatives".

In view of the vital role that the Customs Service plays in interdicting dangerous drugs at our borders, why does the proposed budget call for a $19 million rescission in the air interdiction program for FY86, and a $20.3 million or 27% reduction from the approved FY86 budget for FY87?

[Additional material to be submitted to the Committee for the record.]

Question. The OMB plays a large role in overseeing the various other federal agencies. I support efforts to increase efficiency, but I am troubled by questions that have been raised as to whether OMB, well-intentioned though they may be, might actually be hindering agency efficiency and interfering with the basic mission of Departments like Health and Human Services and Labor. Can you justify all of OMB's oversight actions in terms of OMB's efficiency and the efficiency of the agencies whose actions you review?

Considering the budget balancing pressures of Gramm-Rudman, how can OMB possibly justify a 1987 budget request that is 11.1 percent higher than your 1986 budget authority?

Shouldn't the OMB be showing us leadership by submitting a budget with major reductions rather than major increases?

How do you respond to the statements a few weeks ago by the Secretary of HHS, Dr. Otis Bowen, when he was objecting to OMB's "micromanagement" of the Department?

[Additional material to be submitted to the Committee for the record.]

[The following questions from Mrs. Smith were submitted for the record. Responses were provided by the Office of Management and Budget.]

Question. Despite repeated claims of inflation being under control, decreases in unemployment, increased growth, decreases in interest rates, etc . . . I ask you, what Administration strategies and policies are aimed at reducing the ruinously high interest rates in agriculture?

[Additional material to be submitted to the Committee for the record.]

Question. Has the Farm Credit System approached the Administration for financial assistance in any form? If so, how much? What provisions are made in the President's 1986 and 1987 budget for providing such assistance?

[Additional material to be submitted to the Committee for the record.]

Question. How much will the Administration's cuts to REA increase costs to the consumer?

[Additional material to be submitted to the Committee for the record.]

Question. What reason can you give me for the termination of all conservation and flood control programs?

[Additional material to be submitted to the Committee for the record.]

Question. Given the magnitude of today's agriculture problems, why does our President request an approximate 45 percent cut in Extension Service funding? Many farmers and ranchers are dependent upon technological assistance from the government to solve their home, business, and community problems. Is there any reading as to how many programs will be terminated or cut back and how many states will be able to fulfill their increased funding role in the Extension Service?

[Additional material to be submitted to the Committee for the record.]

[The following questions from Mr. Young (Florida) were submitted for the record. Responses were provided by the Department of the Treasury.]

Before asking my questions, I'd like to take a moment to make a brief observation.

President Reagan is to be commended for his leadership in submitting a budget this year that shows a steadily declining deficit until there is an actual surplus in 1991. The President, however, has been severely criticized the past few weeks for deficits that will raise our national debt to $2 trillion. The truth of the matter is, that no President can spend a single dollar that Congress has not first authorized and appropriated. Those people looking to place blame for our national debt and deficits should look to the Congress to shoulder the responsibility.

President Reagan did not have an opportunity to start with a clean slate. When he took office in January 1981, he inherited a $1 trillion national debt and annual interest payments on that debt which have risen from $117 billion per year to $206.9 billion estimated for fiscal year 1987, a 76.5 percent increase.

From fiscal year 1982, the first budget submitted by President Reagan, through the fiscal year 1987 budget we begin considering today, the President has had no choice but to request and spend $981.7 billion just to pay the interest on the national debt which he inherited. The fact is, that of the $1.080 trillion increase in the national debt under President Reagan, $981.7 billion, or 90.9 percent, went to pay the interest on the national debt he inherited.

The interest on the national debt is one of the fastest growing components of federal spending. Under the last budget of the previous administration, interest on the national debt accounted for 14.1 percent of total federal outlays. In fiscal year 1987, interest will account for more than one-fifth, or 20.8 percent of outlays.

So those who would blame President Reagan for our mounting national debt are laying the blame on the wrong doorstep. In fact, if it was not for the President's bold leadership and persistence in reducing the rate of federal spending increases, our nation would be in even worse financial condition than today.

Question. Mr. Secretary, Congress failed again last year to meet its responsibilities, and as a result, our government ran out of borrowing authority and had to take drastic steps to avoid going into default. Have you calculated the cost to the federal government associated with the failure of Congress to meet its budgetary and fiscal deadlines?

Answer. No, there has been no calculation of the cost to the federal government due to the large number of factors that one could include, and the difficulty in quantifying the cost related to a delay in increasing the limit.

Question. One of the drastic measures taken last fall to prevent default by the government was the cashing in of federal securities held by the social security trust funds. In your dual responsibilities as manager of the social security trust funds and the Secretary of the Treasury, what is the status of the trust funds? Have the trust funds been made whole again and will there be any negative short- or long-term effects on the trust funds as a result of last fall's maneuvers?

Answer. The trust funds have been made whole again and there will be no negative short- or long-term effects to the trust funds as a result of last fall's maneuvers. As authorized by Section 272 of Gramm-Rudman, Treasury took the actions required to fully restore the trust funds in December, 1985.

These actions were:

1. As of December 12, restored $6.267 billion principal amount of 10⅜ obligations maturing 1987 through 1989 that had been prematurely redeemed in September. (The restoration of securities prematurely redeemed in October and November was accomplished as of November 14, as required by the temporary debt limit.)

2. On December 31, we transferred $9.240 million to OASI and $437,000 to DI to compensate for 1985 interest losses. These were almost entirely due to the accelerated November redemptions.

3. On December 31, we transferred $372,286,000 to OASI to compensate it for losses caused by premature redemptions during the 1984 debt limit impasse. (DI was not adversely affected in 1984.) This is subject to adjustment in June 1986 if the June formula interest rate is different than the 9⅞% rate used in the initial calculation.

Question. The President's Budget requests a substantial 21.2 percent increase in funding for multilateral development banks (an increase from $1.143 billion in FY 1986 to $1.392 billion in FY 1987. What is this increase in foreign aid funding to be used for? Has the administration made a decision yet on the upcoming replenishment of funding for IDA, the International Development Association?

Answer. With the exception of an additional $44.4 million of funding for U.S. membership in the Multilateral Investment Guarantee Agency (MIGA), the budget request for FY 1987 is identical to the FY 1986 budget request. The 21.2 percent increase you cite is the difference between the 1986 CR including Gramm-Rudman cuts and the FY 1987 request.

The Administration has not made a decision on funding for the IDA VIII replenishment. We had indicated in the first round of negotiations (January 27-28) that we could support an IDA VIII of between $9 billion and $12 billion with the actual level dependent on whether U.S. policy requests are satisfied. IDA deputies will meet again on April 7.

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Appendix A.—SELECTED BUDGET FEATURES

[In millions of dollars]

	Fiscal year 1985 actual	Fiscal year 1986 estimate	1987 request	1988 projection	1989 projection
Budget Authority	$1,074,063	1,058,736	1,101,985	1,165,900	1,218,000
Outlays	946,322	979,928	994,003	1,026,765	1,063,620
Receipts	734,057	771,139	850,372	933,179	996,115
Deficit	212,266	202,789	143,630	93,586	67,505
(on-budget)	(−221,629)	(−215,984)	(−159,288)	(−126,765)	(−111,304)
(off-budget/Social Security)	(+9,363)	(+13,195)	(+15,658)	(+33,179)	(+43,799)
Borrowing from Trust Fund Surpluses	54,382	63,005	74,596	96,000	108,900
Total—True Deficit	266,648	265,794	218,226	189,586	176,405
Other financing	−15,848	−18,902	−9,341	−426	−1,034
Increase in Debt Subject to Limit	+250,800	+284,696	+208,885	+189,160	+175,371
Total Debt Subject to Limit	1,823,775	2,108,471	2,317,356	2,506,516	2,681,887

Note.—Detail may not add to totals due to rounding. The debt subject to limit on January [illegible] stood at [illegible] million.

Appendix B.—RECEIPTS AND OUTLAYS OF TRUST FUNDS, FISCAL YEAR 1987

[In millions of dollars]

Description	Receipts	Outlays	Surplus (+) or deficit (−)
Federal old age, and survivors, and disability insurance trust funds	$214,275	$198,627	$15,648
Railroad retirement trust funds	9,894	8,618	1,276
Black lung disability trust fund	1,559	1,559	
Veterans life insurance trust funds	1,410	1,272	138
Federal employee retirement funds	46,383	24,997	21,386
Military retirement funds	33,702	20,614	13,088
Unemployment trust fund	25,411	20,971	4,440
Health insurance trust funds	89,320	77,209	12,111
Highway trust funds	13,880	13,072	808
Airport and airway trust fund	2,747	3,533	−786
Foreign military sales trust fund	11,292	11,136	156
Other trust funds	3,377	−550	3,927
Subtotal	454,338	379,494	74,844
Deductions	−21,244	−21,244	
Total	$433,094	$358,250	$74,844

Source: Table C–4, Special Analyses, Budget of the U.S. Government, FY 1987

Appendix [illegible] — REGULAR ANNUAL, SUPPLEMENTAL, AND DEFICIENCY APPROPRIATION BILLS: COMPARISON OF BUDGET REQUESTS AND APPROPRIATIONS AMOUNTS ENACTED

Appendix D.—DISPOSITION OF APPROPRIATED FUNDS, FISCAL YEARS 1981-1986

[Budget Authority]

	President's budget request considered	Final congressional appropriation	Difference over (+) under (−) President
Fiscal year 1981	$431,629,081,133	$428,425,181,587	−$3,203,899,546
Fiscal year 1982	358,130,122,650	360,005,288,449	+1,875,165,799
Fiscal year 1983	497,865,615,516	510,760,913,714	+12,895,298,198
Fiscal year 1984	532,776,761,347	536,583,859,061	+3,807,097,714
Fiscal year 1985	582,964,601,246	[1] 571,740,238,522	−11,224,362,724
Fiscal year 1986	[2] 578,578,550,503	[2] [3] 572,619,032,551	−5,959,517,952

[1] Does not include −$5,375,000,000 rescission for Synfuels.

[2] Does include +$4,000,000,000 request for CCC and +$3,976,000,000 enacted for CCC pursuant to Budget request of 12/23/85.

[3] Does not include −$6,900,000,000 rescission for Synfuels.

Appendix E.—CONTROLLABILITY OF PRESIDENT'S BUDGET REQUEST, FISCAL YEAR 1987

[In millions of dollars]

	Budget authority	Outlays
Relatively uncontrollable under present law:		
Payments for individuals:		
Social Security and railroad retirement	$232,069	$213,076
Federal employees' retirement and insurance	88,856	55,237
Unemployment assistance	22,491	15,319
Medical care	115,877	102,506
Assistance to students	4,744	4,444
Food and nutrition assistance	4,234	4,202
Public assistance and related programs	24,061	23,090
All other relatively uncontrollable payments for individuals	3,171	3,075
Subtotal, payments for individuals	(495,503)	(420,949)
Net Interest	147,303	147,303
Farm price supports (CCC)	15,655	16,326
Other open-ended programs and fixed costs	−16,447	−6,162
(Legislative and Judiciary)	(3,220)	(3,198)
(All other)	(−19,667)	(−9,360)
Outlays from prior-year contracts and obligations		184,960
(National defense)		(106,694)
(Civilian programs)		(78,266)
Permanent authority in relatively controllable programs	21,552	
Total, relatively uncontrollable under present law	663,567	763,376
Relatively controllable:		
National defense	320,083	175,331
Civilian programs	149,982	86,943
Total, relatively controllable	470,065	262,274
Undistributed employer share, employee retirement	−31,648	−31,648
Total	$1,101,985	$994,002

Source: Table 16, "Controllability of Outlays", Budget of the U.S. Government, FY 1987.

Appendix F.—DEPARTMENT OF DEFENSE

[In billions of dollars]

	Unobligated balances	Unexpended balances
Fiscal year:		
1975	$16.7	$44.0
1976 (transition quarter)	21.0	51.4
1977	20.0	62.6
1978	21.3	73.6
1979	23.0	83.9
1980	24.2	92.2
1981	26.5	112.8
1982	34.6	142.2
1983	43.4	172.1
1984	51.6	205.1
1985	61.5	244.3
1986 estimate	59.9	262.4
1987 estimate	60.3	299.7

Appendix G.—ECONOMIC ASSUMPTIONS

[Calendar years, dollar amounts in billions]

	1984 actual	1985 forecast	1986 forecast	1987 forecast
Gross National Product:				
Current dollars	$3,775	$3,992	$4,274	$4,629
Percent Change (year over year, constant 1982 dollars)	6.6	2.3	3.4	4.0
Consumer Price Index:				
Percent Change (year over year)	3.4	3.5	3.5	4.1
Unemployment Rate:				
Percent (annual average)	7.4	7.1	6.7	6.5
Interest Rate, 91-day Treasury Bills:				
Percent	9.6	7.5	7.3	6.5

Source: "Short-Range Economic Forecast", page 2-24, Budget of the U.S. Government, FY 1987

Appendix H.—NET EFFECT OF MAJOR ENACTED LEGISLATION ON RECEIPTS [1]

[In billions of dollars]

	1985	1986	1987	1988	1989	1985-1989
Economic Recovery Tax Act of 1981	−170.3	−207.5	−244.8	−274.0	−303.7	−1,200.3
Tax Equity and Fiscal Responsibility Act of 1982	39.2	49.2	59.2	61.6	61.7	270.8
Highway Revenue Act of 1982	4.2	4.5	4.7	4.8	5.0	23.2
Social Security Amendments of 1983	8.7	8.0	9.2	20.0	24.9	70.9
Interest and Dividends Tax Compliance Act of 1983	−2.4	−2.1	−1.7	−1.8	−2.0	−9.9
Railroad Retirement Revenue Act of 1983	0.7	1.1	1.1	1.1	1.1	5.1
Deficit Reduction Act of 1984	9.3	16.0	21.8	24.9	27.2	99.2
Net tax reduction	−110.5	−130.8	−150.6	−163.3	−185.8	−741.0

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[1] These estimates are based on the direct effect only of legislative changes at a given level of economic activity. Induced effects on the economy are taken into account in forecasting incomes, however, and in this way affect the receipts estimates by major source and in total.

Appendix I.—DATES OF INTEREST TO THE HOUSE APPROPRIATIONS COMMITTEE

99TH CONGRESS, 2D SESSION

Jan. 10	Fiscal Year 1986 "deficit snapshot" taken by OMB and CBO.
Jan. 15	OMB and CBO provide report to GAO detailing reductions necessary to achieve $11.7 billion in savings for fiscal year 1986.
Jan. 21	GAO issues report to President.
Jan. 21	Congress convenes.
Feb. 1	President issues sequestration order. Message submitted to Congress indicating effect of sequestration on each program, project and activity. (An alternative proposal may also be submitted.)
Feb. 5	OMB target to submit budget.
Feb. 6	Date for overview hearing.
Feb. 8 thru 17	District work period.
Feb. 25	Submit views and estimates to Budget Committee.
Mar. 1	Sequestration order takes effect.
Mar. 26 thru Apr. 6	District work period.
Apr. 1	GAO issues report indicating whether Presidential order complies with Gramm-Rudman requirements.
Apr. 15	Congress shall complete action on budget resolution.
May 15	Appropriations bills may be considered in the House even if the budget resolution is not yet adopted.
May 23 thru 27	District work period.
June 10	All annual appropriations bills for fiscal year 1987 must be reported from House Appropriations Committee.
June 15	Congress shall complete action on a reconciliation bill reported pursuant to instructions in the budget resolution.
June 30	House must approve all fiscal year 1987 appropriations bills in order to consider July 4th recess resolution.
June 28 thru July 6	District work period.
July	Supreme Court determination on constitutionality of Gramm-Rudman expected.
Aug. 16 thru Sept. 7	August recess.
Aug. 15	Fiscal Year 1987 deficit snapshot taken by OMB and CBO.
Aug. 20	OMB and CBO submit initial report to GAO detailing reductions necessary to reduce deficit to $144 billion for fiscal year 1987.
Aug. 25	GAO issues initial report to President.
Sept. 1	President issues initial sequestration order. Message submitted to Congress indicating effect on each program, project and activity. (Alternative proposal may also be submitted.)
Sept. 5	President transmits to GAO and Appropriations and Armed Services Committees a report concerning defense contracts proposed to be terminated or modified.
Sept. 30	GAO certifies which contract savings are reasonable and achievable.
	FISCAL YEAR 1987 STARTS
Oct. 1	Resources identified in September order are withheld from obligation until final order is effective.
Oct. 3	ADJOURNMENT TARGET.
Oct. 5	OMB and CBO submit a revised report to GAO reflecting Congressional actions since first report.
Oct. 10	GAO issues revised report.
Oct. 15	President issues final order sequestering resources and transmits message to Congress (including any alternatives) with full details.
Nov. 15	GAO issues report to Congress and the President explaining extent to which President's order complies with Gramm-Rudman requirements.

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